

Retail

Company Report
August 12, 2019

(Maintain) **Trading Buy**

Target Price(12M, W) ▼ **42,000**

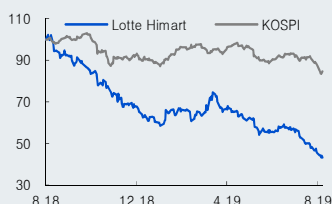
Share Price (08/09/19, W) **33,500**

Expected Return **25%**

OP (19F, Wbn)	155
Consensus OP (19F, Wbn)	158
EPS Growth (19F, %)	22.2
Market EPS Growth (19F, %)	-26.1
P/E (19F, x)	7.6
Market P/E (19F, x)	11.9
KOSPI	1,937.75

Market Cap (Wbn)	791
Shares Outstanding (mn)	24
Free Float (%)	38.6
Foreign Ownership (%)	13.7
Beta (12M)	1.01
52-Week Low	33,500
52-Week High	78,800

(%)	1M	6M	12M
Absolute	-19.0	-34.7	-56.9
Relative	-14.2	-26.6	-48.8



Mirae Asset Daewoo Co., Ltd.

[Retail]

Myoungjoo Kim
+822-3774-1458
myoungjoo.kim@miraeasset.com

Lotte Himart

(071840 KS)

A challenging environment; Patience is needed

2Q19 review: Earnings miss due to softening demand for home appliances

For 2Q19, Lotte Himart reported revenue of W1.07tr (-1.5% YoY) and operating profit of W45.8bn (-31.6% YoY), falling short of our forecasts and consensus expectations. We attribute the earnings miss to: 1) weak consumer sentiment; 2) softening demand for large home appliances due to fewer move-ins; and 3) the high online penetration of home appliances. Promotions were scaled back, supporting cost ratio improvement (to 73% vs. 77% in 1Q19), but the resulting slowdown in top-line growth led to negative operating leverage effects.

Aside from dryers (which have a low market penetration) and air conditioners (a seasonal appliance), sales declined across all categories. TV sales declined by double digits on a tough comparison, and sales of large appliances (e.g., refrigerators and kimchi refrigerators) also saw negative growth, hurt by weak demand. Sales also declined for small appliances (which drove Lotte Himart's revenue growth and margin improvement in 2018) due to an unfavorable comparison and better air quality.

A challenging environment

The operating environment remains challenging in 2H19. We expect: 1) demand for large appliances to soften amid falling apartment move-ins (-15% in 2019 and -17% in 2020); and 2) top-line growth to slow due to the high online penetration of home appliances. In 2Q19, online penetration in the home appliance market remained high (44% vs. 46% in 1Q19), as online retailers such as Coupang and Auction continued to expand aggressively into the home appliance category to increase their transaction volumes. Because home appliances are a fairly standardized category, Lotte Himart will have to resort to discounts and promotions to gain share in the online space. We expect the online penetration of home appliances to remain high for some time, as online platforms are competing for market share. As such, Lotte Himart's top-line growth and margins look set to weaken in 2H19. That said, we expect revenue to recover in 2020, supported by: 1) the expansion of differentiated stores (omni, premium, and mega); and 2) the possibility of replacement demand for some home appliances.

Lower TP to W42,000, but maintain Trading Buy

We maintain our Trading Buy rating on Lotte Himart. We lower our target price to W42,000 (from W53,000), as we cut our 2019 and 2020 net profit estimates by 2.4% and 1.8%, respectively, to reflect: 1) the likelihood of softer large appliance demand amid fewer move-ins; and 2) intensifying competition between online and offline channels. Given the high online penetration of home appliances, we applied a 25% discount to the multiple of 2011, when home appliance demand weakened due to a fall in apartment move-ins.

Demand for large appliances continues to soften amid intensifying competition in both the offline and online space. In our view, expansion into new, differentiated home appliance categories that can drive traffic is critical for the stock to meaningfully recover. We believe ongoing store differentiation, when done meaningfully, will enhance Lotte Himart's competitiveness.

FY (Dec.)	12/15	12/16	12/17	12/18	12/19F	12/20F
Revenue (Wbn)	3,896	3,939	4,099	4,113	4,238	4,363
OP (Wbn)	160	175	207	186	155	173
OP Margin (%)	4.1	4.4	5.1	4.5	3.7	4.0
NP (Wbn)	107	121	148	85	104	121
EPS (W)	4,515	5,144	6,288	3,620	4,423	5,139
ROE (%)	6.1	6.6	7.6	4.2	5.0	5.6
P/E (x)	13.1	8.2	11.0	12.9	7.6	6.5
P/B (x)	0.8	0.5	0.8	0.5	0.4	0.4
Dividend Yield (%)	0.7	1.2	2.7	3.6	5.1	5.1

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

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Table 1. TP calculation

(Wbn, W, x, %)

Avg. 19-20F net profit	112	
P/E multiple	8.9	25% discount to the 2011 level of 11.8x (when sales slowed due to declining apartment move-in volume)
Fair market cap	995	
Shares outstanding ('000)	23,608	
TP	42,000	
Current price	33,500	As of August 9, 2019
Upside (%)	25	

Source: Company data, Mirae Asset Daewoo Research

Table 2. 2Q19 review

(Wbn, %, %p)

	2Q18	1Q19	2Q19			Growth	
			Actual	Mirae Asset Daewoo	Consensus	YoY	QoQ
Revenue	1,087	1,037	1,071	1,117	1,122	-1.5	3.3
Operating profit	67	24	46	50	52	-31.6	88.6
OP margin (%)	6.2	2.3	4.3	4.5	39.4	-1.9	1.9
Net profit	50	15	31	35	39	-37.2	102.4

Note: All figures are based on non-consolidated K-IFRS.

Source: DataGuide; company data, Mirae Asset Daewoo Research

Table 3. Earnings forecast revisions

(Wbn, %)

	Previous		Revised		% chg.		Notes
	2019F	2020F	2019F	2020F	2019F	2020F	
Revenue	4,284	4,411	4,238	4,363	-1.1	-1.1	
Operating profit	158	176	155	173	-2.1	-1.7	
OP margin (%)	3.7	4.0	3.7	4.0	0.0	0.0	
Net profit	107	123	104	121	-2.4	-1.8	

Note: All figures are based on non-consolidated K-IFRS.

Source: DataGuide; Mirae Asset Daewoo Research

Table 4. Quarterly and annual earnings

(Wbn)

	1Q17	2Q17	3Q17	4Q17	1Q18	2Q18	3Q18	4Q18	1Q19	2Q19	3Q19F	4Q19F	2017	2018	2019F	2020F
Revenue	897	1,064	1,182	957	952	1,087	1,113	960	1,037	1,071	1,143	987	4,099	4,113	4,238	4,363
Gross profit	222	298	318	213	241	297	302	232	239	285	305	239	1,061	1,073	1,067	1,109
SG&A	196	236	237	184	200	231	238	219	214	239	243	216	854	886	912	936
Operating profit	36	61	81	29	41	67	65	13	24	46	62	23	207	186	155	173
Pretax profit	34	60	80	26	39	65	63	-41	20	42	57	18	199	127	137	159
Net profit	25	45	60	17	30	50	48	-46	15	31	44	14	148	85	104	121
(YoY)																
Revenue	1.0	11.9	5.4	-2.4	6.2	2.2	-5.8	-0.2	8.9	-1.5	2.7	2.8	4.1	0.3	3.1	2.9
Operating profit	30.1	50.0	21.8	-26.5	13.7	9.3	-20.0	-53.7	-41.3	-31.6	-4.0	69.3	18.9	-10.1	-16.9	11.8
Net profit	33.9	57.2	31.7	-37.3	17.0	9.5	-20.0	TTR	-48.4	-37.2	-9.7	-133.2	22.2	-42.4	21.7	16.2

Note: All figures are based on non-consolidated K-IFRS.

Source: Company data, Mirae Asset Daewoo Research

Lotte Himart (071840 KS/Trading Buy/TP: W42,000)

Comprehensive Income Statement (Summarized)

(Wbn)	12/17	12/18	12/19F	12/20F
Revenue	4,099	4,113	4,238	4,363
Cost of Sales	3,038	3,040	3,172	3,254
Gross Profit	1,061	1,073	1,066	1,109
SG&A Expenses	854	886	912	936
Operating Profit (Adj)	207	186	155	173
Operating Profit	207	186	155	173
Non-Operating Profit	-8	-59	-18	-14
Net Financial Income	-10	-8	-18	-15
Net Gain from Inv in Associates	0	0	0	0
Pretax Profit	199	127	137	159
Income Tax	51	41	32	37
Profit from Continuing Operations	148	85	104	121
Profit from Discontinued Operations	0	0	0	0
Net Profit	148	85	104	121
Controlling Interests	148	85	104	121
Non-Controlling Interests	0	0	0	0
Total Comprehensive Profit	142	80	99	121
Controlling Interests	142	80	99	121
Non-Controlling Interests	0	0	0	0
EBITDA	257	234	282	222
FCF (Free Cash Flow)	222	22	180	167
EBITDA Margin (%)	6.3	5.7	6.7	5.1
Operating Profit Margin (%)	5.1	4.5	3.7	4.0
Net Profit Margin (%)	3.6	2.1	2.5	2.8

Cash Flows (Summarized)

(Wbn)	12/17	12/18	12/19F	12/20F
Cash Flows from Op Activities	252	72	196	179
Net Profit	148	85	104	121
Non-Cash Income and Expense	126	167	181	101
Depreciation	43	40	121	44
Amortization	6	7	6	5
Others	77	120	54	52
Chg in Working Capital	24	-126	-57	-5
Chg in AR & Other Receivables	-3	1	-6	-3
Chg in Inventories	-16	-21	-14	-16
Chg in AP & Other Payables	23	-93	7	7
Income Tax Paid	-46	-56	-34	-37
Cash Flows from Inv Activities	-53	-21	-15	-8
Chg in PP&E	-28	-49	-16	-12
Chg in Intangible Assets	-6	-8	-1	0
Chg in Financial Assets	-7	49	-3	-4
Others	-12	-13	5	8
Cash Flows from Fin Activities	-27	-80	-243	-212
Chg in Financial Liabilities	0	-20	129	-150
Chg in Equity	0	0	0	0
Dividends Paid	-12	-44	0	-40
Others	-15	-16	-372	-22
Increase (Decrease) in Cash	171	-30	-62	-41
Beginning Balance	158	329	300	238
Ending Balance	329	300	238	196

Source: Company data, Mirae Asset Daewoo Research estimates

Statement of Financial Condition (Summarized)

(Wbn)	12/17	12/18	12/19F	12/20F
Current Assets	930	915	870	848
Cash and Cash Equivalents	329	300	237	196
AR & Other Receivables	93	93	95	98
Inventories	478	499	513	529
Other Current Assets	30	23	25	25
Non-Current Assets	2,275	2,202	2,447	2,414
Investments in Associates	0	0	0	0
Property, Plant and Equipment	403	413	325	292
Intangible Assets	1,708	1,653	1,648	1,643
Total Assets	3,205	3,117	3,317	3,262
Current Liabilities	847	538	420	383
AP & Other Payables	397	303	312	322
Short-Term Financial Liabilities	330	130	0	-50
Other Current Liabilities	120	105	108	111
Non-Current Liabilities	332	517	777	677
Long-Term Financial Liabilities	320	499	758	658
Other Non-Current Liabilities	12	18	19	19
Total Liabilities	1,179	1,055	1,196	1,060
Controlling Interests	2,026	2,062	2,120	2,202
Capital Stock	118	118	118	118
Capital Surplus	1,056	1,056	1,056	1,056
Retained Earnings	862	888	947	1,028
Non-Controlling Interests	0	0	0	0
Stockholders' Equity	2,026	2,062	2,120	2,202

Forecasts/Valuations (Summarized)

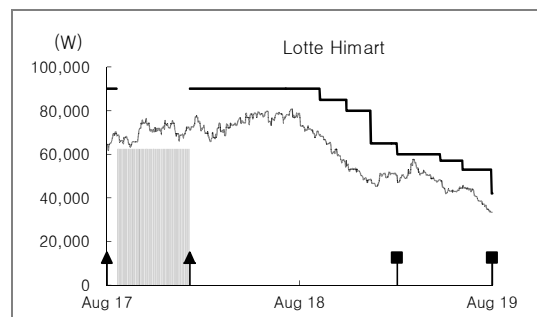
	12/17	12/18	12/19F	12/20F
P/E (x)	11.0	12.9	7.6	6.5
P/CF (x)	5.9	4.4	2.8	3.6
P/B (x)	0.8	0.5	0.4	0.4
EV/EBITDA (x)	7.5	6.0	4.6	5.3
EPS (W)	6,288	3,620	4,423	5,139
CFPS (W)	11,630	10,699	12,111	9,410
BPS (W)	85,810	87,338	89,821	93,260
DPS (W)	1,850	1,700	1,700	1,700
Payout ratio (%)	29.4	47.0	38.4	33.1
Dividend Yield (%)	2.7	3.6	5.1	5.1
Revenue Growth (%)	4.1	0.3	3.0	2.9
EBITDA Growth (%)	13.2	-8.9	20.5	-21.3
Operating Profit Growth (%)	18.3	-10.1	-16.7	11.6
EPS Growth (%)	22.2	-42.4	22.2	16.2
Accounts Receivable Turnover (x)	48.4	45.5	46.2	46.2
Inventory Turnover (x)	8.7	8.4	8.4	8.4
Accounts Payable Turnover (x)	10.7	12.4	15.3	15.2
ROA (%)	4.8	2.7	3.2	3.7
ROE (%)	7.6	4.2	5.0	5.6
ROIC (%)	7.0	5.7	4.9	5.3
Liability to Equity Ratio (%)	58.2	51.2	56.4	48.1
Current Ratio (%)	109.8	170.1	207.3	221.5
Net Debt to Equity Ratio (%)	14.8	15.0	23.6	17.8
Interest Coverage Ratio (x)	12.8	11.1	6.4	7.9

APPENDIX 1

Important Disclosures & Disclaimers

2-Year Rating and Target Price History

Company (Code)	Date	Rating	Target Price
Lotte Himart (071840)	08/11/2019	Trading Buy	42,000
	06/17/2019	Trading Buy	53,000
	05/06/2019	Trading Buy	57,000
	02/13/2019	Trading Buy	60,000
	12/25/2018	Buy	65,000
	11/09/2018	Buy	80,000
	09/20/2018	Buy	85,000
	01/16/2018	Buy	90,000
	08/31/2017	No Coverage	
	07/30/2017	Buy	90,000



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.

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* 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 & Investment Banking Services

	Buy	Trading Buy	Hold	Sell
Equity Ratings Distribution	83.14%	8.72%	8.14%	0.00%
Investment Banking Services	77.78%	11.11%	11.11%	0.00%

* Based on recommendations in the last 12-months (as of June 30, 2019)

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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 Brasil Tel: 55-11-2789-2100
PT. Mirae Asset Sekuritas Indonesia Equity Tower Building Lt. 50 Sudirman Central Business District Jl. Jend. Sudirman, Kav. 52-53 Jakarta Selatan 12190 Indonesia Tel: 62-21-515-3281	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	