Lotte Himart (071840.KS)

Home appliance cycle slowing

Company Comment | Aug 12, 2019

Weighed upon by both a y-y weakening in demand for seasonal household appliances (eg, air conditioners) and high-base effect (y-y) for large household appliance sales, Lotte Himart's 2Q19 results arrived sluggish. The pace of the firm's sales growth for environmentally-friendly home appliances has slowed amid filling market penetration. Besides the slowing in sales for seasonal home appliances, earnings were dented by saturation in the large home appliances market. Reflecting these negatives, we lower our TP from W52,000 to W38,000.

Home appliance market momentum slowing

Revising down 2019E EPS in light of a slowing home appliance cycle and the firm's sluggish 2Q19 results, we lower our TP on Lotte Himart by 27% from W52,000 to W38,000.

Although the market for environmentally-friendly home appliances (such as air purifiers, vacuum cleaners, and dryers) had been showing rapid growth, the pace of this expansion has been slowing as of late with their penetration rates likely having reached their peak levels. The markets for large household appliances (including refrigerators and washing machines) also appear saturated, and the negative growth in TV sales continues.

But, at Lotte Himart's current share price (Aug 9: W33,500), we estimate dividend yield of 5% based on last year's DPS of W1,700, assuming the firm's DPS remains unaltered as expected. Therefore, we believe that any additional fall in the company's share price would be excessive.

2Q19 review: Both sales and margins deteriorate

Lotte Himart announced non-consolidated 2Q19 sales of W1.7tn (-2% y-y) and OP of W45.8bn (-32% y-y), with OP missing consensus by 12%.

We attribute the drop in the 2Q19 top line to both tepid sales of seasonal household appliances (eg, air conditioners) and high-base effect (y-y) for large household appliance sales. While Lotte Himart's online mall continued to show high sales growth (44% y-y), the discounted ASPs for the firm's online offerings dampened overall GPM. In addition, the company booked higher SG&A expenses (including labor costs and commissions), translating into a 1.9%p y-y narrowing in OPM.

No rebound trend appears in sight for Lotte Himart's environmental, seasonal, and large home appliance sales in 3Q19. With online competition continuing to intensify, the company's GPM is to be under downward pressure going forward.

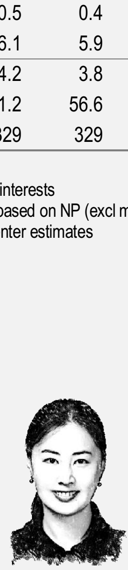
Hold (maintain)

TP	**W38,000 (lower)**
CP (19/08/09)	**W33,500**
Sector	**Retail**
Kospi/Kosdaq	1,937.75 / 590.04
Market cap (common)	US$651.48mn
Outstanding shares (common)	23.6mn
52W high ('18/08/10)	W78,800
low ('19/08/09)	W33,500
Average trading value (60D)	US$1.88mn
Dividend yield (2019E)	5.97%
Foreign ownership	13.7%
Major shareholders	
Lotte Shopping and 2 others	61.0%
NPS	8.1%

Share perf	3M	6M	12M
Absolute (%)	-29.9	-34.7	-56.9
Relative (%p)	-24.0	-26.6	-48.8

	2018	2019E	2020F	2021F
Sales	4,113	4,156	4,267	4,333
Chg	*0.3*	*1.0*	*2.7*	*1.6*
OP	186	154	160	165
Chg	*-10.1*	*-17.6*	*4.5*	*2.6*
OPM	*4.5*	*3.7*	*3.8*	*3.8*
NP	85	79	86	91
EPS	3,620	3,342	3,623	3,853
Chg	*-42.4*	*-7.7*	*8.4*	*6.3*
P/E	12.9	10.0	9.2	8.7
P/B	0.5	0.4	0.4	0.4
EV/EBITDA	6.1	5.9	5.5	5.1
ROE	4.2	3.8	4.0	4.2
Debt/equity	51.2	56.6	50.8	46.0
Net debt	329	329	255	181

Unit: Wbn, %, won, x
Note 1: NP excludes minority interests
Note 2: EPS, P/E, P/B, ROE based on NP (excl minority interests)
Source: NH I&S Research Center estimates



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2Q19 review (non-consolidated) (Unit: Wbn, %)

	2Q18	3Q18	4Q18	1Q19	2Q19P					3Q19E
					Actual	y-y	q-q	Estimate	Consens	
Sales	1,087	1,113	960	1,037	1,071	-1.5	3.3	1,147	1,122	1,102
OP	66.9	64.7	13.4	24.3	45.8	-31.5	88.5	53.9	51.9	55.1
OPM	*6.2*	*5.8*	*1.4*	*2.3*	*4.3*			*4.7*	*4.6*	*5.0*
Pre-tax profit	65.2	63.4	-40.9	20.1	42.2	-35.2	110.0	53.1	51.9	54.3
NP	49.5	48.2	-42.1	15.4	32.1	-35.2	108.4	39.8	39.4	40.7

Source: Lotte Himart, FnGuide, NH I&S Research Center estimates

Earnings forecasts (IFRS non-consolidated) (Unit: Wbn, won, x, %)

		2018	2019E	2020F	2021F
Sales	- Revised	4,112.7	4,155.6	4,266.9	4,333.1
	- Previous	-	4,340.6	4,505.8	4,616.8
	- Change	-	-4.3	-5.3	-6.1
OP	- Revised	186.5	153.6	160.5	164.6
	- Previous	-	173.0	191.7	200.9
	- Change	-	-11.2	-16.3	-18.0
OPM	- Revised	*4.5*	*3.7*	*3.8*	*3.8*
EBITDA		234.3	191.0	190.6	189.0
NP (excl minority interests)		85.5	78.9	85.5	91.0
EPS	- Revised	3,620	3,342	3,623	3,853
	- Previous	-	4,030	4,726	5,142
	- Change	-	-17.1	-23.3	-25.1
P/E		12.9	10.0	9.2	8.7
P/B		0.5	0.4	0.4	0.4
EV/EBITDA		6.1	5.9	5.5	5.1
ROE		4.2	3.8	4.0	4.2

Note: EPS, P/E, P/B, and ROE based on NP (excluding minority interests)
Source: NH I&S Research Center estimates

Relative valuation (Unit: Wbn, x, won)

	Value (Wbn)	Value/share (won)	Remarks
Operating value	904	38,307	
12M fwd NP	82	3,482	12M FWD NP
P/E multiple	X 11.0	X 11.0	Home appliance retail sector's historical average P/E of 11 x
Value of Lotte Himart	904	38,307	**2019E P/E of 11.5 x**
Outstanding shares (won)	23,607,712	23,607,712	

Source: NH I&S Research Center estimates

Quarterly income statement snapshot (Unit: Wbn, %)

	1Q18	2Q18	3Q18	4Q18	2018	1Q19	2Q19P	3Q19E	4Q19F	2019E
Sales	**952.5**	**1,087.0**	**1,113.0**	**960.3**	**4,112.7**	**1,037.0**	**1,070.9**	**1,101.8**	**945.9**	**4,155.6**
y-y (%)	*6.3%*	*2.4%*	*-5.7%*	*-0.3%*	*0.3%*	*8.9%*	*-1.5%*	*-1.0%*	*-1.5%*	*1.0%*
GP*	**241.0**	**297.5**	**302.3**	**232.1**	**1,072.9**	**238.6**	**267.7**	**281.0**	**228.9**	**1,016.2**
y-y (%)	*8.8%*	*0.0%*	*-2.5%*	*-3.3%*	*1.1%*	*-1.0%*	*-10.0%*	*-7.1%*	*-1.4%*	*-5.3%*
GPM	25.3%	27.4%	27.2%	24.2%	26.1%	23.0%	25.0%	25.5%	24.2%	24.5%
OP	**41.4**	**66.9**	**64.7**	**13.4**	**186.5**	**24.3**	**45.8**	**55.1**	**28.4**	**153.6**
y-y (%)	*13.7%*	*9.3%*	*-20.0%*	*-53.5%*	*-10.1%*	*-41.3%*	*-31.5%*	*-14.9%*	*111.0%*	*-17.6%*
OPM	4.3%	6.2%	5.8%	1.4%	4.5%	2.3%	4.3%	5.0%	3.0%	3.7%
Pre-tax profit	**39.2**	**65.2**	**63.4**	**-40.9**	**126.9**	**20.1**	**42.2**	**54.3**	**-12.4**	**104.2**
y-y (%)	*16.3%*	*9.5%*	*-20.2%*	*적전*	*-36.2%*	*-48.7%*	*-35.2%*	*-14.4%*	*적지*	*-17.9%*
Pre-tax margin	4.1%	6.0%	5.7%	-4.3%	3.1%	1.9%	3.9%	4.9%	-1.3%	2.5%
NP (excl minority interests)	**29.8**	**49.5**	**48.2**	**-42.1**	**85.5**	**15.4**	**32.1**	**40.7**	**-9.3**	**78.9**
y-y (%)	*17.0%*	*9.5%*	*-20.0%*	*적전*	*-42.4%*	*-48.4%*	*-35.2%*	*-15.5%*	*적지*	*-7.7%*
NPM	3.1%	4.6%	4.3%	-4.4%	2.1%	1.5%	3.0%	3.7%	-1.0%	1.9%

Note: IFRS non-consolidated
* : 2Q19 figures based on our estimates
Source: NH I&S Research Center estimates

STATEMENT OF COMPREHENSIVE INCOME

(Wbn)	2018/12A	2019/12E	2020/12F	2021/12F
Sales	**4,113**	**4,156**	**4,267**	**4,333**
Growth (%)	0.3	1.0	2.7	1.6
COGS	**3,040**	**3,139**	**3,221**	**3,271**
Gross Profit	**1,073**	**1,016**	**1,045**	**1,062**
Gross margin (%)	26.1	24.5	24.5	24.5
SG&A	886	863	885	897
Operating Income	**186**	**154**	**160**	**165**
Growth (%)	-10.1	-17.6	4.5	2.6
Operating margin (%)	4.5	3.7	3.8	3.8
EBITDA	**234**	**191**	**191**	**189**
Non-Operating Profit	**-60**	**-49**	**-46**	**-43**
Financial Income(Costs)	-8	-10	-7	-4
Other Non-Operating Profit	-52	0	0	0
Gains(Losses) in Associates, Subsidiaries and JVs	0	-39	-39	-39
Pre-tax Profit from Cont. Op.	**127**	**104**	**114**	**121**
Income Taxes	**41**	**25**	**29**	**30**
Profit from Continuing Op.	85	79	86	91
Net Profit	**85**	**79**	**86**	**91**
Growth (%)	-42.4	-7.7	8.4	6.3
Net margin (%)	2.1	1.9	2.0	2.1
Net Profit of Parent	85	79	86	91
Net Profit to Non-Controlling	0	0	0	0
Other Comprehensive Income	-6	0	0	0
Total Comprehensive Income	80	79	86	91

Valuation / Profitability / Stability

	2018/12A	2019/12E	2020/12F	2021/12F
Price/Earnings (x)	12.9	10.0	9.2	8.7
Price/Book Value (x)	0.5	0.4	0.4	0.4
Price/Gross Cash Flow (x)	4.4	5.6	5.5	5.4
Price/Sales (x)	0.3	0.2	0.2	0.2
EV/EBITDA (x)	6.1	5.9	5.5	5.1
EV/EBIT (x)	7.7	7.3	6.5	5.9
Fully diluted EPS (won)	3,620	3,342	3,623	3,853
BVPS (won)	87,338	88,980	90,903	93,056
Sales PS (won)	174,209	176,027	180,741	183,545
ROE (%)	4.2	3.8	4.0	4.2
ROA (%)	2.7	2.5	2.6	2.8
ROIC (%)	5.8	4.7	4.7	4.9
Dividend Yield (%)	3.6	6.0	7.5	7.5
Payout Ratio (%)	47.0	50.9	46.9	44.1
Total Cash Dividend (Wbn)	40	40	40	40
Cash DPS (won)	1,700	2,000	2,500	2,500
Net debt(cash)/ equity (%)	16.0	15.7	11.9	8.2
Debt/ equity (%)	51.2	56.6	50.8	46.0
Interest-Bearing Debts (Wbn)	629	762	662	581
Current Ratio (%)	170.1	154.1	155.3	159.3
Total shares (mn)	24	24	24	24
Par value (won)	5,000	5,000	5,000	5,000
Share price (won)	46,650	33,500	33,500	33,500
Market Cap (Wbn)	1,101	791	791	791

STATEMENT OF FINANCIAL POSITION

(Wbn)	2018/12A	2019/12E	2020/12F	2021/12F
Cash and Cash Equivalents	300	174	148	141
Accounts Receivables	91	91	91	91
Total Current Assets	**915**	**791**	**767**	**763**
Tangible Assets	413	375	345	321
Investment Assets	121	121	121	122
Non-Current Assets	**2,202**	**2,499**	**2,469**	**2,445**
Assets	**3,117**	**3,290**	**3,236**	**3,208**
Short-Term Debt	130	104	83	67
Account Payables	205	205	206	207
Current Liabilities	**538**	**513**	**494**	**479**
Long-Term Debt	499	658	579	515
Long-Term Allowance	16	16	17	17
Non-Current Liabilities	**517**	**676**	**596**	**533**
Liabilities	**1,055**	**1,190**	**1,090**	**1,011**
Capital Stock	118	118	118	118
Capital Surplus	1,056	1,056	1,056	1,056
Retained Earnings	888	927	972	1,023
Non-Controlling Interests Equity	0	0	0	0
Shareholders' Equity	**2,062**	**2,101**	**2,146**	**2,197**

CASH FLOW STATEMENT

(Wbn)	2018/12A	2019/12E	2020/12F	2021/12F
Operating Cash Flow	**72**	**116**	**115**	**115**
Net Profit	85	79	86	91
Depreciation & Amortization	48	37	30	24
+ Loss(Gains) from Subs	0	0	0	0
+ FC translation loss(profit)	0	0	0	0
Gross Cash Flow	253	142	144	146
- Incr. (Decr.) in WC	-126	-1	-1	-1
Investing Cash Flow	**-21**	**-335**	**0**	**0**
+ Decr. In Tangible Assets	0	0	0	0
- Incr. In Tangible Assets (capex)	-49	0	0	0
+ Disp.(Acq.) of Inv. Assets	29	0	0	0
Free Cash Flow	22	116	115	115
Net Cash Flow	51	-219	115	114
Financing Cash Flow	**-80**	**93**	**-141**	**-121**
Equity Financing	0	0	0	0
Debt Financing	-80	93	-141	-121
Incr.(Decr.) in Cash	-30	-126	-26	-6
Ending Cash and Cash Equivalents	300	174	148	141
Net Debt (Cash)	329	329	255	181

Rating and TP update

Date	Rating	TP	Disparity ratio (%) Avg	Disparity ratio (%) Max/Min
2019.08.12	Hold	W38,000(12M)	-	-
2019.05.09	Hold	W52,000(12M)	-20.4%	-
2019.02.13	Hold	W55,000(12M)	-7.5%	-
2018.11.08	Buy	W70,000(12M)	-28.2%	-20.6%
2018.07.30		No change for 1 year	-20.4%	-7.1%

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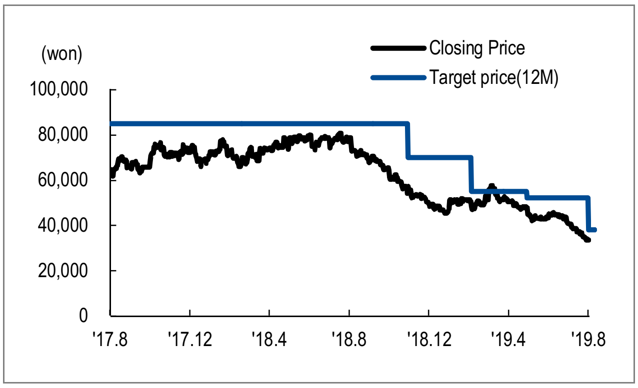

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- Sell: Less than -15%

2. Regarding listed companies under NH I&S' coverage, our stock ratings break down as follows (as of Aug 9, 2019).

- NH I&S' stock rating distribution

Buy	Hold	Sell
77.7%	22.3%	0.0%

- The stock rating on an individual company can change at irregular intervals. Our stock rating distribution is calculated on a weekly basis.

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