Lotte Hi-Mart (071840 KS)

Retail

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Rating	BUY (M)
Target price	W50,000 (U)
Current price (Nov 6)	W31,500
Upside potential	59%

Market cap (Wbn)	744
Shares outstanding	23,607,712
Avg daily T/O (2M, Wbn)	3
Avg daily volume (2M, shrs)	103,622
52-week high (won)	38,500
52-week low (won)	11,250
Foreign ownership (%)	12.4
Major shareholders (%)	
Lotte Shopping & others	61.0

Stock performance

(%)	1M	3M	12M
Absolute	2.6	7.9	(6.1)
Relative	0.5	4.6	(16.7)
Abs (US$)	6.3	14.0	(3.1)

3Q20 review: premium appliance sales surge

3Q20 review: growth and cost control

- Lotte Hi-Mart reported 3Q20 sales of W1,047.3bn (+6.5% YoY) and OP of W55.9bn (+67.3% YoY). OP beat both consensus (W47.1bn) and our estimate (W48.4bn) significantly. Sales growth was in line with estimates, while margin beat our estimate significantly thanks to cost controls.
- While air conditioner sales fell sharply (-20% YoY) on seasonality, most other categories saw over 10% growth, driving top-line growth.
- As mentioned, active cost control were the key driver of strong 3Q20 results. Specifically, labor cost fell by W2.6bn YoY and ad & PR expense by W7.5bn YoY. Gross margin narrowed by 0.5%p YoY, mainly because sales of high-margin air conditioners (-20% YoY) declined, thus hurting product mix.
- In 3Q20, restructuring of unprofitable stores continued, with one road shop and six shop-in-shops closed. Store closures will likely reduce loss by W100mn~200mn per store.

Premium home appliance trend to continue

- Home appliance sales growth this year was not driven by increased sales volume but higher prices. Customer spending on premium home appliances rose significantly. In fact, the company's premium home appliance sales rose 59% YoY in 3Q20. This is in line with a rapid rise in luxury goods sales in department stores, as consumers increasingly focus more on getting higher satisfaction from products no matter the cost. We believe COVID-19 accelerated the release of premium home appliances, but expect this trend to continue. Despite concerns over growth in 2021 on base effect from this year, we expect sales to continue growing in 2021. Moreover, expectations for a turnaround in air conditioner sales, which posted huge negative growth for two straight years, will likely raise the possibility of earnings growth.
- We maintain BUY and revise up target price to W50,000 on higher earnings estimate.

Quarterly earnings

(Wbn)	3Q20P	% YoY	% QoQ	Consens	vs consens (%)
Sales	1,047	6.5	-6.1	1,039	0.8
OP	56	67.3	-19.3	47	18.8
EBT, continuing ops	50	76.6	-12.6	45	11.8
Net profit, CI	38	76.1	-12.5	34	11.9
OPM (%)	5.3	+1.9 %pt	-0.9 %pt	4.5	+0.8 %pt
NPM (%)	3.6	+1.4 %pt	-0.3 %pt	3.3	+0.3 %pt

Note: CI = controlling interest, Source: Yuanta Securities

Forecasts and valuations (K-IFRS, consolidated) (Wbn)

FY ends Dec	2018A	2019A	2020E	2021E
Sales	4,113	4,026	4,052	4,206
OP	186	110	166	197
Net profit, CI	85	-100	104	133
P/E (x)	19.1	-9.6	7.1	5.6
P/B (x)	0.8	0.5	0.4	0.4
EV/EBITDA (x)	8.3	6.5	4.2	3.8
ROE (%)	4.2	-5.0	5.3	6.6

Source: Yuanta Securities

Lotte Hi-Mart (071840 KS) pro forma financial statements (K-IFRS, consolidated)

Statement of comprehensive income

FY ends Dec (Wbn)	2018A	2019A	2020E	2021E	2022E
Sales	**4,113**	**4,026**	**4,052**	**4,206**	**4,304**
Cost of sales	3,040	3,026	3,041	3,154	3,228
Gross profit	1,073	1,001	1,011	1,052	1,076
SG&A	886	891	846	855	868
Operating profit	**186**	**110**	**166**	**197**	**209**
EBITDA	234	245	304	334	344
Non-op profit/loss	-60	-194	-29	-22	-21
Forex gain/loss	0	0	0	0	0
Net interest income	-8	-14	-16	-16	-15
Equity-meth gain/loss	0	0	0	0	0
Other	-52	-180	-13	-6	-6
Net prof before income tax	127	-84	137	175	188
Income tax	41	16	33	42	45
Net profit from continuing ops	85	-100	104	133	143
Net profit from discontinued ops	0	0	0	0	0
Net profit	85	-100	104	133	143
NP for controlling interest	**85**	**-100**	**104**	**133**	**143**
Total comprehensive income	80	-100	105	137	147
Total comprehensive income, CI	80	-100	105	137	147

Note: Operating profit calculation same as K-GAAP (sales - COGS - SG&A exp)

Statement of financial position

FY ends Dec (Wbn)	2018A	2019A	2020E	2021E	2022E
Current assets	**915**	**716**	**991**	**958**	**1,032**
Cash & cash equivalents	300	50	288	240	298
Accts rec & other	93	97	109	111	113
Inventory	499	532	567	579	592
Non-current assets	2,202	2,392	2,374	2,374	2,369
Tangible assets	413	437	449	451	446
Investment in affiliates	0	0	0	0	0
Other non-current	121	146	144	144	144
Total assets	**3,117**	**3,108**	**3,365**	**3,332**	**3,401**
Current liabilities	538	590	779	784	789
Accts payable & other	316	298	290	294	299
ST financial liabilities	0	0	0	0	0
Liquid LT liabilities	130	130	280	280	280
Non-current liabilities	517	596	583	533	483
LT financial liabilities	130	100	0	0	0
Debentures	369	270	369	319	269
Total liabilities	**1,055**	**1,186**	**1,362**	**1,316**	**1,271**
Equity, controlling interest	2,062	1,922	2,003	2,016	2,130
Paid-in capital	118	118	118	118	118
Capital surplus	1,056	1,056	1,056	1,056	1,056
Retained earnings	888	748	828	837	947
Equity, non-controlling interest	0	0	0	0	0
Total equity	**2,062**	**1,922**	**2,003**	**2,016**	**2,130**
Net debt	**309**	**627**	**537**	**535**	**427**
Total debt	629	711	850	800	750

Cash flow statement

FY ends Dec (Wbn)	2018A	2019A	2020E	2021E	2022E
Operating cash flow	**72**	**130**	**373**	**445**	**457**
Net profit	85	-100	104	133	143
Depreciation & amortization	40	128	131	130	129
Forex gain/loss	0	0	0	0	0
Affiliate invest gain/loss	0	0	0	0	0
Inc (dec) in net working cap	-126	-100	-20	10	6
Other	71	202	159	172	179
Investing cash flow	**-21**	**-106**	**-68**	**-74**	**-75**
Investment	45	-3	-1	0	0
Inc in tangible assets	-49	-67	-67	-64	-64
Dec in tangible assets	0	0	0	0	0
Other	-17	-36	0	-10	-11
Financing cash flow	**-80**	**-275**	**21**	**-174**	**-179**
Inc (dec) in ST fin liab	0	0	0	0	0
Inc (dec) in LT fin liab	-20	-130	149	-50	-50
Inc (dec) in equity	0	0	0	0	0
Cash dividend	-44	-40	-24	-28	-33
Other	-16	-105	-105	-95	-96
Other cash flow	0	0	-89	-245	-146
Inc (dec) in cash & equivalents	**-30**	**-250**	**238**	**-47**	**58**
Beginning cash & equivalents	329	300	50	288	240
Ending cash & equivalents	300	50	288	240	298
NOPLAT	186	131	**166**	**197**	**209**
FCF	**-1**	**100**	**177**	**233**	**236**

Valuation

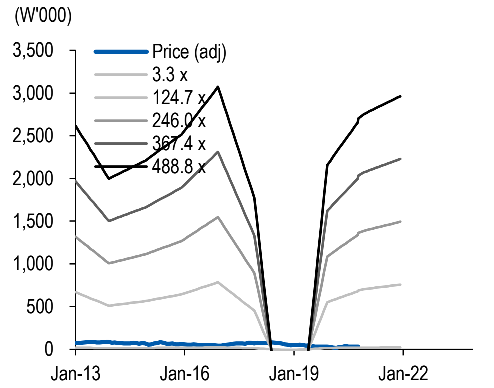
FY ends Dec	2018A	2019A	2020E	2021E	2022E
EPS (won)	3,620	-4,232	4,411	5,634	6,062
BPS (won)	87,338	81,410	84,857	85,403	90,224
EBITDA/shr (won)	9,925	10,396	12,873	14,168	14,586
SPS (won)	174,209	170,557	171,653	178,153	182,333
DPS (won)	1,700	1,000	1,200	1,400	1,400
P/E (x)	**19.1**	**-9.6**	**7.1**	**5.6**	**5.2**
P/B (x)	**0.8**	**0.5**	**0.4**	**0.4**	**0.3**
EV/EBITDA (x)	**8.3**	**6.5**	**4.2**	**3.8**	**3.4**
P/S (x)	**0.4**	**0.2**	**0.2**	**0.2**	**0.2**

Key financial data

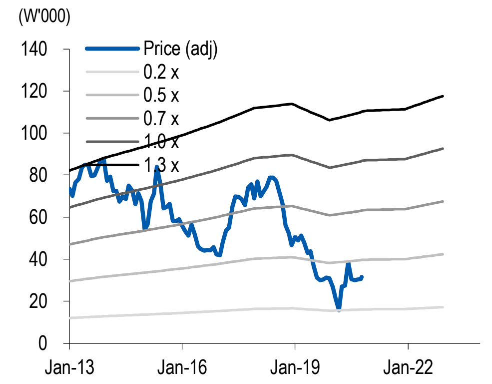
FY ends Dec	2018A	2019A	2020E	2021E	2022E
Sales (% YoY)	**0.3**	**-2.1**	**0.6**	**3.8**	**2.3**
Operating profit (%YoY)	**-10.1**	**-41.1**	**50.9**	**18.8**	**6.0**
Net profit, CI (%YoY)	**-42.4**	**TTR**	**TTB**	**27.7**	**7.6**
Gross margin (%)	26.1	24.9	25.0	25.0	25.0
Operating margin (%)	**4.5**	**2.7**	**4.1**	**4.7**	**4.9**
Net margin, CI (%)	2.1	-2.5	2.6	3.2	3.3
EBITDA margin (%)	5.7	6.1	7.5	8.0	8.0
ROIC (%)	5.7	5.9	5.7	6.8	7.2
ROA (%)	2.7	-3.2	3.2	4.0	4.3
ROE (%)	**4.2**	**-5.0**	**5.3**	**6.6**	**6.9**
Debt-to-equity (%)	51.2	61.7	68.0	65.3	59.7
Net debt-to-equity (%)	15.0	32.6	26.8	26.5	20.0
OP/financing cost (x)	11.1	5.3	8.0	9.8	11.1

Note: CI = controlling interest
EPS, BPS, P/E and P/B are based on controlling interest
For valuation metrics such as P/E, historical figures are based on annual average prices and estimates, on current price
For ROA or ROE, assets and equity are averages of end-of-year figures for the given year and the year prior
Source: Yuanta Securities

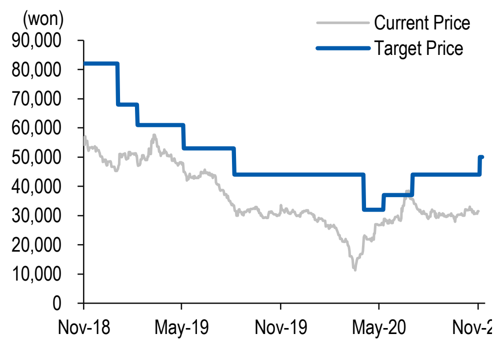
P/E band chart



P/B band chart



Lotte Hi-Mart (071840 KS) ratings and target price history



Date	Rating	TP (won)	TP time frame	Difference (%)	
				vs avg price	vs high (low)
2020/11/09	BUY	50,000	1 yr		
2020/07/07	BUY	44,000	1 yr	-29.79	-19.55
2020/05/15	BUY	37,000	1 yr	-15.16	4.05
2020/04/08	BUY	32,000	1 yr	-24.21	-13.91
2019/08/12	BUY	44,000	1 yr	-37.25	-23.75
2019/05/10	BUY	53,000	1 yr	-21.97	-13.77
2019/02/13	BUY	61,000	1 yr	-16.70	-5.57
2019/01/08	BUY	68,000	1 yr	-26.01	-23.97
2018/10/15	BUY	82,000	1 yr	-35.43	-24.02

Note: Difference = (actual price* - target price) / target price x 100
* 1) The average price until the day target price was suggested
2) The highest (lowest) price until the day target price was suggested
Source: Yuanta Securities

Current distribution of Yuanta Securities Korea ratings

Rating	Share (%)
STRONG BUY	0.6
BUY	89.1
HOLD	10.3
SELL	0.0
Total	100.0

Note: As of Nov 6 xcluding reports written or published by overseas affiliates

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- **Stock ratings** include an Investment Rating (Strong Buy, Buy, Hold, Sell) based on the expected absolute return of a stock over the next 6 -12 months.
- - Strong Buy: Expected to return 30% or more
  - Buy: Expected to return between 10% and 30%
  - Hold: Expected to return between -10 and +10%
  - Sell: Expected to return -10% or less
- **Sector ratings** suggest 6 to 12 - month forward investment weighting of a given sector compared to its market capitalization weighting.
  - Overweight: Investment weighting is higher than the market capitalization weighting
  - Neutral: Investment weighting is equal to the market capitalization weighting
  - Underweight: Investment weighting is lower than the market capitalization weighting

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