AmorePacific (090430)

BUY (Maintain), TP W1,160,000 (Maintain)

China's growth story remains intact; regulatory concerns overblown

BUY, despite the lack of a near-term catalyst: We derived our 12-month-forward target price of W1,160,000 using the sum-of-parts methodology. The target price is the sum of: 1) the core operating value of AmorePacific (applying three-year EV/EBITDA average of 12.5x to 2010F EBITDA) and 2) the Chinese subsidiary's value (applying a 2010F EV/sales multiple of 6.1x to the subsidiary's 2010F sales). The target price equals a 2011F PER of 20.4x and PEG of 1.2x.

The stock declined 27.8% from its previous high reached in September on 1) investors' profit realization following a 6-month rally and 2) concerns over government regulations regarding a delay in the launch of Sulhwasoo in 2H10. The delay in the premium line Sulwhasoo is of course a short-term negative because it was the only event to drive up the stock price amid the lack of catalyst in 2H10. Nevertheless, the Chinese subsidiary's growth story of CAGR of 38.4% in 2009-2015 remains valid and if the stock's price is beaten down due to regulatory risks in China, it would provide investors with a buying opportunity. We maintain BUY on 1) domestic business' robust growth story, 2) a higher OP margin than its global peers and 3) the likelihood of sales expansion in China.

Chinese subsidiary enters expansionary phase; concerns over government regulations are overblown: As AmorePacific's successful entry into the Chinese market has already been raved about for the past couple of years, a key share price variable is whether the Chinese subsidiary's value will increase. In the near-term, it is important to lift sales after the store additions. We believe the company's expansion strategy is feasible as: 1) the number of Chinese department stores stood at 6,000, and 2) Chinese market leaders such as P&G and L'Oreal had about 800 counters in department stores as of 1H10 (vs. Laneige's 180 and Mamonde's 277). During our visit to China, we found local companies such as Shanghai Jahwa have posed only marginal threats to foreign brands and preference for brands such as Shiseido and AmorePacific among the Chinese has been on the rise thanks to Chinese's increasing interest in "Asian Beauty." The company's ongoing push to launch Sulwhasoo is significant not only in solidifying the company's luxurious, premium image but also in taking the fast-expanding herbal medicine cosmetics market earlier than its competitors. Although the launch of Sulwhasoo has been delayed on the Chinese government's stricter licensing process for all imports, we view the outlook for the company to obtain the license as positive.

November 4, 2010 / W1,070,000 / Mkt cap: USD5,647.9mn, KRW6,255bn

Yr to Dec	Sales (W bn)	OP (W bn)	EBT (W bn)	NP (W bn)	EPS (won)	% chg. (YoY)	EBITDA (W bn)	P/E (x)	EV/EBITDA (x)	P/B (x)	ROE (%)
2008A	1,531	255	244	170	28,225	(4.4)	318	23.2	11.9	4.1	16.5
2009A	1,769	301	299	226	37,658	33.4	374	24.8	14.7	5.1	18.7
2010F	1,995	359	383	289	48,489	28.8	441	22.1	14.1	5.1	20.8
2011F	2,215	410	447	338	56,812	17.2	498	18.8	12.3	4.7	21.8
2012F	2,436	465	521	394	66,384	16.8	558	16.1	10.7	4.2	22.9

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Domestic premium channels remain intact; masstige store additions target met: The premium sales channels such as department stores and door-to-door have continued to grow. Concerns were raised over a high base of comparison in 2009 regarding the department store channel. But in reality, the company's sales at department stores are estimated to have grown 22% YoY in 2010F, led by duty-free shops. Door-to-door sales should increase 9% YoY in 2010F, as sales agents recruited en masse during the economic downturn in 2009 will gradually contribute to sales. AmorePacific owed 25% of sales growth to its specialty Aritaum shops. The full-year opening target of 1,150 Aritaum stores was already met in 2Q10. Hence, we expect the company to focus more on bolstering the top line on the back of same-store sales growth rather than adding shops.

1. China's present and future cosmetics market

At present the third-largest market, but to be the world's second-largest market in 2015

Cosmetics sector retreated due to strict government control, but…

China's cosmetics market has continued strong growth thanks to open market reform (deregulation) and rising income levels

As a symbol of capitalism, the cosmetics sector was under Beijing's strict control up until the early 1980s. Back then, companies were not allowed to manufacture products other than soap and emulsion, not to mention staging marketing or R&D efforts. Even Shanghai Jahwa, the no. 1 Chinese cosmetics company which boasts a history of more than 120 years, managed to launch a brand with a full lineup featuring basic skincare to makeup products only in 1984. In the process, most local cosmetics companies, due to a lack of capital and brand power, went bankrupt. However, the open market reforms in China served as a remarkable milestone for the Chinese cosmetics sector. Deregulation of the sector coupled with rising income levels drove up cosmetics demand exponentially in the country. Moreover, foreign cosmetics companies armed with capital and brand power (P&G, L'Oreal and Shiseido) entered the Chinese market and launched marketing blitzes, which further expanded the market. As a result, the Chinese cosmetics market displayed CAGR of 12.6% in 2000-2009.

Robust growth potential to continue given rising income levels and advanced nations' cosmetics consumption

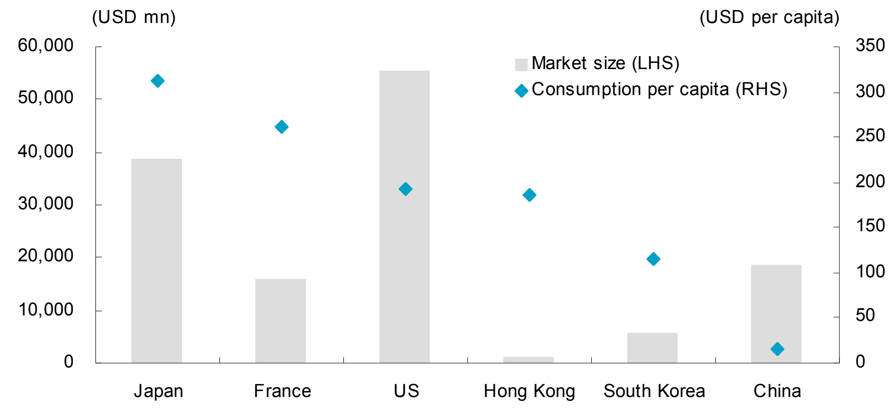
China to become the world's second-largest cosmetics market in 2015

We forecast the Chinese cosmetics market to deliver a CAGR of 18.7% in 2009-2015F and become the world's second-largest market after the US in 2015. Our optimistic prediction is based on 1) Chinese consumers' far lower spending on cosmetics than those in advanced nations. While per-capita cosmetics consumption stands at 8-9 items in Korea and other advanced countries, it stands at less than 2.5 in China. In short, China's consumers mostly do not use products other than soap and emulsion. Even consumers residing in major cities use 4-5 items, which is far less than advanced countries' average. Given the rising income levels and spread of western consumption patterns in China, we predict cosmetics consumption to surge not only in major cities but also tier-2 and tier-3 cities and rural areas.

Masstige market emerging as a new growth engine

The premium market led by the department store channel has driven the Chinese cosmetics market. However, a mass market has also emerged as: 1) the middle class has broadened on rising income levels and 2) rural populations have migrated to urban areas. In light of these demographic changes, global players including Shiseido have aggressively sought expansion of mass-market channels such as discount stores and drugstores while AmorePacific has worked to expand department store channels of its masstige line, Mamonde.

Cosmetics' market size and per-capita spending on cosmetics by major market



Source: Euromonitor

2. AmorePacific's standing in China and keys to success

AmorePacific ranked 14th in Chinese market by sales but its cosmetics brand, Laneige ranked 9th in brand awareness

AmorePacific succeeded in Chinese market entry; effectively one of the top-five companies

Since the Chinese subsidiary's establishment in 2000 and launch of Laneige in 2002, AmorePacific has successfully made forays into the Chinese market – the company ranked 14th by sales in 2009 and one of its brands, Laneige ranked 9th by brand awareness in 2008. The company should be recognized for the 14th ranking with just two brands, given higher ranking foreign companies (P&G, L'Oreal and Shiseido) and Chinese companies (Jiangsu Longliqi and Shanghai Jahwa) own numerous brands encompassing skincare, makeup and personal care (hair and body care) products. Moreover, considering the top nine brands are owned by only four companies other than AmorePacific, we see that the company is, in effect, one of the top-five cosmetics companies in China.

"Korean Wave" and interest in Asian beauty

"Korean Wave" and interest in "Asian beauty" boosted the popularity of Shiseido and AmorePacific

The "Korean Wave" or popularity of Korean pop culture greatly contributed to heightened status of Korean cosmetics in the Chinese market. In addition, steeply rising interest in "Asian beauty" among the Chinese has also created favorable conditions for AmorePacific to build a stronger presence in the market. The Beijing Olympics and global financial crisis in 2008 served as opportunities to boost Chinese consumers' pride in their culture and economic status on the global stage. Hence, attention has been paid on premium brands of foreign companies which know the skin types and preferences of the Chinese. That is the reason why skincare products from Shiseido and AmorePacific, Asian companies, saw their popularity surge in the country.

Selective focus through clear positioning strategies; leading brand building

Success in China thanks to the 1) selective fostering of two competitive brands and 2) strict brand and inventory management

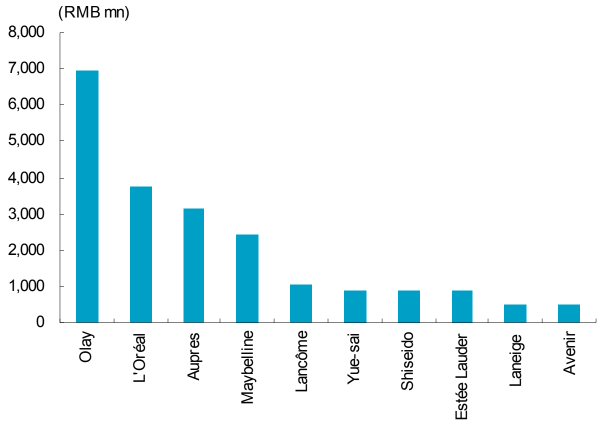
However, the Korean Wave and interest in Asian beauty are not sufficient to explain AmorePacific's success in the Chinese market. Other Korean companies such as LG Household & Healthcare (LG H&H) advanced into the market as early as AmorePacific, but failed to build such a strong presence. In a nutshell, the success factors of AmorePacific boil down to 1) its securing of leading brands that are comparable to brands of foreign companies which command 59.1% of the Chinese market, 2) selective fostering of two brands based on clear positioning strategies (young premium Laneige line; high mass Mamonde line) and 3) strict brand and inventory management through department store channels. In particular, Laneige strengthened the "moisture" concept in the light that Chinese women's primary area of interest is retaining skin moisture, which resulted in a huge success and enabled the brand to build a presence in the foreign-brand rich premium market. Another indicator of Laneige's brand power in China is the fact that the most purchased brand by Chinese tourists in Korea is Laneige.

Cosmetics brand ranking by sales in China (as of 2009)

	Company	CAGR (05-09, %)	Market share (%)
1	L'Oreal	22.9	17.5
2	P&G	4.3	11.2
3	Shiseido	23.7	9.6
4	Avon	9.2	6.2
5	Amway	8.8	6.2
6	Mary Kay	6.2	4.1
7	Jiangsu Longliqi	11.1	3.1
8	Beiersdorf	31.9	2.7
9	Estée Lauder	25.9	2.7
10	J&J	36.6	2.5
11	Shanghai Jahwa	23.6	2.3
12	Unilever	11.5	2.0
13	Kosé	9.2	1.7
14	AmorePacific	32.3	1.7
15	Fancl Corp.	114.1	1.2

Source: Euromonitor

Ranking by brand awareness in China (as of 2008)



Source: Euromonitor

Chinese market entry and strategies by cosmetics company

(W bn, %)

	AmorePacific	LG H&H	Woongjin Coway	TheFaceShop	Able C&C	Etude	Kolmar Korea	Cosmax
Market entry	2000	1995	2000	2006	2006	2011	2007	2004
Operating results								
Market share (2009)	0.92	0.30	0.11	0.03	0.04	n/a	n/a	n/a
Sales (2009)	117.6	39.2	14.7	9.0	5.1	n/a	n/a	14.7
(% of total sales)	5.7	8.4	1.0	3.5	2.8	n/a	n/a	12.3
Sales value (2010F)	150.2	40.0	17.8	10.0	15.0	n/a	10.0	25.0
(% of total sales)	6.5	2.3	1.2	3.5	6.2	n/a	10.0	16.7
Net margin (2009)	11.3	(32.1)*	45.2	n/a	29.4	n/a	n/a	11.6
Net margin (2010F)	9.5	(5.0)*	39.0	n/a	13.3	n/a	n/a	10.0
2006-2009 sales CAGR	29.3	3.3	132.1	n/a	n/a	n/a	n/a	105.3
2009-2011 sales CAGR	29.9	7.7	n/a	n/a	n/a	n/a	n/a	n/a
Business overview								
Positioning	Department stores, premium products	Premium brands	Niche markets, local demand (high-priced)	Mid to low-end	Mid-end (at double prices than in Korea)	Total makeup	Basic color cosmetics OEM	Local OEM
Brand	Two brands (Laneige, Mamonde)	Eight brands (Ohui, Whoo, SooRyeHan, etc.)	Six brands (Ruhen, Cellart, Terreau, etc.)	TheFaceShop	Missha	Etude	n/a	n/a
Distribution channels	Department stores, (423) specialty stores (1,935)	Department stores, specialty stores (662)	Provincial distribution agents (57), shops (7,860)	Brand shop (100)	Brand shop (240)	Brand shop	n/a	n/a
Future growth momentum								
Subsidiary/capex				Chinese subsidiary to be established in Sep 2010			Beijing factory of KRW50bn capacity (June, 2010)	Capacity addition (no. 2 plant)
Distribution channels	Department store counter additions (short-term), door-to-door sales networks (mid to long-term)	Store additions	Store additions, channel diversification (esthetics, road shops, etc.)		Channel diversification (health & beauty chain stores)		Cooperation with Kolmar Beijing	
Brand/marketing	Ad campaigns, new brand launches	Greater margin through premium-line extension	Ad campaigns				Steady R&D, especially functional cosmetics	Greater brand power through localizing efforts

Note: 1) *LG H&H is based on operating margin (%)
2) Woongjin Coway's 2010F earnings are company guidance
3) Market share breakdown is based on Chinese cosmetics market worth USD11.03bn in 2009.
Source: Company data

3. Business overview

Korean brand stores frequently spotted in major shopping areas of tier-1 and tier-2 cities

China is an advanced market in terms of the diversity of multinational brands and distribution channels

During our visit to tier-1 and tier-2 cities in China, we found that although they lag behind Korea in cosmetics consumption and local companies' production level, they, especially large cities, are superior to Korea in such aspects as the number of multinational brands in operation and distribution channel diversification. Many brands not launched in Korea are operating in China, category-killer cosmetics retailer Sephora has opened stores in China and the brand shop concept and drugstore channel have already developed significantly.

High awareness of and access to Korean cosmetics products

Other Korean cosmetics companies than AmorePacific has yet to reach the top position as the company did. However, in Shanghai and Nanjing, we could witness high market access to and awareness of Korean cosmetics products. Brand shops of not only AmorePacific's major brands but also TheFaceShop and Missha were frequently spotted on major shopping streets and at large shopping malls. In addition, midsized brands in Korea such as Somang and Charmzone were also selling at higher prices than local brand products at Korean cosmetics exclusive multi-brand shops in Carrefour.

Laneige entered major upscale department stores

Has sufficient potential to add counters in department stores relative to foreign brands

As of 1H10, Laneige and Mamonde entered 51 and 75 cities, 180 and 277 department stores, respectively. We believe the expansion strategy is feasible as: 1) the number of Chinese department stores stands at more than 6,000, and 2) Chinese market leaders such as P&G, L'Oreal and Shiseido have 600-800 counters in department stores. AmorePacific has the head office of the Chinese subsidiary and production plant in Shanghai. To strike a fine balance between localization and globalization, the company manufactures products of young premium line Laneige in Korea and imports to China and manufactures mass market line Mamonde with more focus on localization in China.

With a popular ad model, Laneige appealed to young consumers

Laneige entered both Shinsegae and Jiuguang Department Stores, the most upscale department stores, we visited and they had little difference in store interior and lineup with stores in Korean department stores. Products were selling at prices high enough to offset tariffs and logistics costs. For example, a basic moisture cream is priced at RMB245 (about W40,000), 27% higher than in Korea. While most foreign brands use advertising models with low awareness in China, Laneige hired Song Hye-gyo, its own model in Korea who also has high popularity in China, which we view as a successful factor to appeal to Chinese consumers in their 20s.

AmorePacific is less competitive than global brands in counter area and location at specialty shops

Should increase sales by launching more brands and improve brand awareness by more aggressive TV marketing

The key distribution channel of Laneige and Mamonde is the department store channel based on direct sales. Thus, the two brands have smaller counter areas and less favorable locations at specialty stores such as Sephora than Shiseido and L'Oreal do. More specifically, Shiseido occupies four counters near the entrance while Laneige and Mamonde occupy one and a half counter far from the entrance, respectively, at a Sephora shop inside a Carrefour store in Shanghai with high Korean and Japanese populations. To lift sales and market share going forward, AmorePacific needs to launch more brands. In addition, by adopting more aggressive TV marketing campaigns, the company hopes to boost Mamonde's brand awareness, which is now about 50% of similarly priced brands, Aupres (Shiseido), Yeu-sai/Paris (L'Oreal) and Olay (P&G).

4. Competitive landscape and outlook

Foreign premium brands hold a tight grip on the market; local brands' presence negligible

Global brands' dominance to continue in the Chinese cosmetics market

As of 2009, foreign brands (including AmorePacific) commanded 59.1% of the entire Chinese cosmetics market, based on its grip on the department store channel, representing 31.1% of the entire distribution channels. The brand power of Chinese cosmetics companies pale next to the foreign brands, except Shanghai Jahwa, which owns herbal medicine cosmetics brand Herboist. We think foreign brands will maintain their overwhelming market dominance, as: 1) Chinese companies' portfolios are still focused on basic products (body emulsion and basic facial emulsion) and 2) the gap between foreign and Chinese brands remains wide in terms of R&D, production and marketing strategies in the aftermath of government regulation of the industry. Furthermore, market dominance of foreign brands will only strengthen based on their efforts to 1) obtain additional growth engines and 2) acquire local brands to release products that are more tailored to Chinese consumers (i.e. P&G's acquisition of Yes-Sia and Mininurse).

The key is market growth, not competition among companies

Exponential growth of the Chinese cosmetics market to drive growth of market leaders

For the next few years, we believe the exponential growth of the Chinese cosmetics market will drive the growth of market leaders, including AmorePacific, rather than a fierce competition among the companies to obtain a greater market share. We predict AmorePacific to deliver sales CAGR of more than 30% over the mid- to long-term on improvement of its own competency: strengthened TV ad campaign and the aggressive addition of counters in department stores. Thus, an analysis of competitors holds no significance when forecasting AmorePacific's mid- to long-term growth potential. But such an analysis may offer the company lessons to learn from its rivals to improve its competitiveness in the long-term. And we selected Shanghai Jahwa and Shiseido as the subjects of analysis because of their similarity in using the "Asian beauty" marketing tactic although they are not in direct competition.

Lessons from Shanghai Jahwa IR meeting: High demand for herbal medicine cosmetics

The success of Shanghai Jahwa's Herboist confirmed high demand for and interest in herbal medicine cosmetics

Shanghai Jahwa ranks 11^{th} by sales in the Chinese cosmetics market (as of 2009) and one of its brands, Herboist ranks 15^{th} in terms of brand awareness (as of 2008). It is the only noteworthy local cosmetics company in China for 1) its 120-year history, 2) its brand improvement efforts via joint R&D with global cosmetics companies and 3) the success of its own brand, Herboist amid the prevalence of foreign brands and entry into more than 70 overseas shops in partnership with Sephora, a division of the world's leading luxury products group LVMH. At Shanghai Jahwa's IR meeting, however, we found that 1) with the exception of Herboist, the company lacks brands to compete with foreign brands – 70% of its sales are generated with household goods and 2) thus the company does not pose a serious threat to AmorePacific.

Sulwhasoo, a herbal medicine cosmetic brand, to improve AmorePacific's image

Despite Shanghai Jahwa's inferiority to foreign companies in technology, marketing and brand power, Herboist was hugely successful thanks to high demand for and interest in herbal medicine cosmetics. Sulwhasoo, which AmorePacific is working to launch as a high-end brand in China, should have limited distribution channels relative to Laneige or Mamonde. But as an herbal medicine cosmetics brand, Sulwhasoo will improve the image of AmorePacific. Currently, AmorePacific lags behind Shiseido in terms of brand identity of "representing Asian Beauty."

Lessons from Shiseido: Acquisition of broad customer base through brand and channel diversification

Shiseido has diverse brands and distribution channels

Shiseido ranks 3rd by sales in the Chinese cosmetics market and its brands, Aupres and Shiseido, rank 3rd and 7th in terms of brand awareness as of 2008, respectively. The cosmetics company, which has the highest brand awareness in China, owned 850 counters in department stores and more than 7,200 specialty shops as of 1H10. To date, the company has launched nine brands in China including Chinese market exclusive brand Aupres. In fact, during a visit to China, we could see that it was Shiseido who has the strongest presence in China among foreign cosmetics companies. The company has recently started to target the masstige market to fill the void created with growth slowdown of Aupres, which currently enjoys overwhelming market dominance. As part of the efforts, in December 2009, Shiseido launched DQ, a new brand for drugstores where L'Oreal's Vichy has a 70% market share (selling at about 2,000 shops).

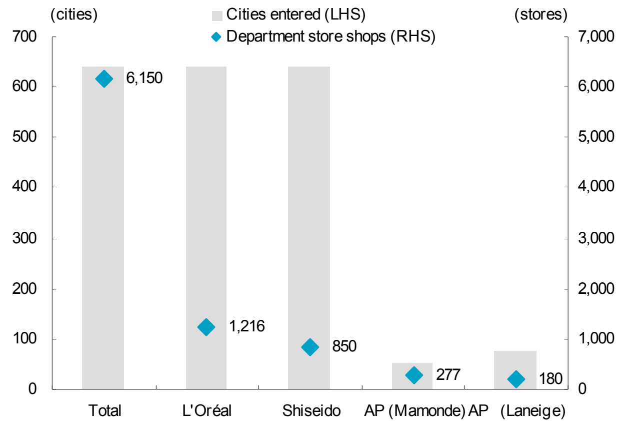
Aggressive marketing (solidify "Asian beauty" image), brand and channel diversification

Lessons for AmorePacific to learn from Shiseido include 1) aggressive marketing to improve its "Asian beauty" image and 2) swift brand and channel diversification to target the market. Of course, AmorePacific should not blindly deploy strategies at Shiseido, whose main products already have market dominance. But given the feedback AmorePacific is receiving from domestic and overseas markets about its slow response to new brand launches or market changes, the company should not overlook that foreign brands which experienced success in the Chinese market far earlier than the company are preparing diverse measures to target mass-market channels.

Shanghai Jahwa's Herboist store

Source: Korea Investment & Securities

Number of cities and department stores where cosmetics companies are operating (as of 1H10)



Source: Company data, Korea Investment & Securities

5. Mid- to long-term earnings outlook

A goal of 38.4% sales CAGR attainable based on addition of Laneige and Mamonde counters in department stores

Committed to raising Chinese subsidiary's sales contribution (to 20% by 2015) based on channel expansion and tailored marketing strategies

Although AmorePacific is regarded as a prime beneficiary of Chinese consumption, the Chinese subsidiary generated only 5.7% of the company's sales and 5.4% of EBT in 2009. Thus, if the China story is to make a substantial contribution to the company's value, sales should grow to a more meaningful level. In this regard, AmorePacific is determined to boost the Chinese subsidiary's sales contribution to 20% (our estimate is 19.5%) by 2015, based on 1) more aggressive channel expansion (addition of 80 department stores annually by 2015 under the goal of increasing the number of cities where it operates from 100 to 300) and 2) marketing and advertising strategies tailored for each brand.

Room for store expansion given number of competitors' stores

We believe the company's expansion strategy is feasible as: 1) the number of Chinese department stores stood at 6,000, and 2) top three Chinese market leaders had about 800 counters in department stores as of 1H10 (vs. Laneige's 180 and Mamonde's 277). We predict the store additions of existing brands alone to deliver sales CAGR of 38.4% in 2009-2015. The rate of return should decline in the near-term due to higher marketing expenses to expand its market share (net rate of return forecast at 9.5%, down 1.8%p from 2009 for the next three years), but long-term profitability is positive.

Brand and channel diversification provide additional mid- to long-term growth engines

Launch of more brands and entry into the door-to-door sales market are additional growth engines

Although we did not factor in our sales estimates, 1) additional brand launches and 2) entry into the door-to-door sales market might also provide growth engines to the company in the mid- to long-term. In particular, three to four more brands after Sulwhasoo and Etude are likely to be launched by 2015. Although the launch of Sulwhasoo has been delayed due to Beijing's stricter licensing process for all imports from April 2010, we view the outlook for the company to obtain the license as positive. The launch of Sulwhasoo is significant not only in solidifying the company's luxurious, premium image but also in taking the fast-expanding herbal medicine cosmetics market earlier than its competitors. Mamonde and Etude and other brands likely to be launched in China are also important in targeting the mass market, a newly emerging growth engine.

SWOT analysis

Strength	Weakness
· Overwhelming brand and distribution channel power in the Korean market · High brand awareness in the Asian market · Swift response to changes in distribution channel · R&D capability, high customer trust in product quality	· Leading brands' entry into saturation stage · Somewhat sluggish launch of follow-up brands · Limited growth potential given domestic market dominance
AmorePacific	
· Surging interest in 'Asian beauty' in China · Ample room to add stores compared to foreign rivals	· Delays in product launch on stricter government regulations · Near-term profitability to weaken on execution of higher marketing expenses
Opportunity	**Threat**

Source: Korea Investment & Securities

6. Recommendation and valuation

Stock price declined 27.8% on delay in Sulwhasoo launch

The stock price corrected on the increasing likelihood of delays in Sulwhasoo's launch and obtainment of a door-to-door business license

From April to September 2010, AmorePacific surged to 46% (24.3x 2010F PER and 29.7% above the four-year average) on 1) higher-than-expected cosmetics sales growth and 2) the potential to benefit from Chinese consumption growth. Despite the lack of an additional catalyst or the remote possibility of an earnings surprise, the stock rallied on the expectation for its "China story." However, on the rising likelihood of delays in the launch of Sulwhasoo and the acquisition of a door-to-door business license in China, the two factors that supported the expectations, investors took profits, and drove down the stock by 27.8% from its previous high reached in September (16.7x 2010F PER).

BUY for the long-term, despite the lack of a near-term catalyst

Lack of near-term momentum; but valid China story

The delay in the premium line Sulwhasoo is a short-term negative. However, AmorePacific's mid- to long-term sales growth goal is attainable through the addition of stores for its existing two brands (Laneige and Mamonde). Thus, the Chinese subsidiary's story remains intact, although the company lacks a near-term catalyst to drive the stock price. Nevertheless, we maintain long-term BUY on 1) domestic business' robust growth story, 2) a higher OP margin than its global peers and 3) the likelihood of sales expansion in China.

Price target of W1,160,000

We derived our 12-month-forward target price of W1,160,000 using a sum-of-parts methodology. The target price is the sum of: 1) the core operating value of AmorePacific (applying the three-year EV/EBITDA average of 12.5x to 2010F EBITDA) and 2) the Chinese subsidiary's value (applying a 2010F EV/Sales multiple of 6.1x to the subsidiary's 2010F sales). The target price equals a 2011F PER of 20.4x and PEG of 1.2x.

Valuation comparison of global cosmetics companies

(USD mn, x, %)

Country	Company	Ticker	Mkt. cap.	PER (x)			EPS CAGR(%)	PEG (x)	Sales growth (%)		OP margin (%)		ROE (%)	
				2009A	2010F	2011F	(09-11F)	2010F	2010F	2011F	2010F	2011F	2010F	2011F
Korea	AmorePacific	4911.JP	5,252	24.8	22.1	18.8	20.8	0.8	12.8	11.0	18.0	18.5	20.8	21.8
	LG H&H	4452.JP	5,522	41.9	30.0	25.1	25.6	0.8	15.0	12.9	13.9	14.8	34.8	33.7
Japan	Shiseido	4911.JP	5,165	19.8	23.7	18.2	2.8	(1.5)	7.2	4.3	9.3	8.9	7.9	10.1
	Kao	4452.JP	8,466	27.0	20.1	18.1	14.2	0.6	1.2	2.3	9.2	9.0	9.5	10.5
	Kose	4922.JP	879	21.2	18.7	16.9	7.9	1.4	1.7	2.2	7.2	7.1	5.8	6.3
US	Estee Lauder	EL.US	8,465	25.8	22.3	19.3	10.1	1.4	8.3	5.8	13.9	13.1	29.4	29.3
	Avon	AVP.US	12,332	16.7	15.0	13.2	8.3	8.0	6.9	7.7	19.1	19.2	45.6	46.2
	P&G	PG.US	182,477	15.6	16.2	14.7	2.0	(5.2)	4.1	4.4	22.4	21.5	19.1	20.3
France	L'Oreal	OR.FR	50,712	24.7	21.1	19.2	8.8	1.2	10.8	5.0	17.4	16.5	16.4	16.4
	Christian Dior	CDI.FR	29,226	28.2	19.3	16.4	19.7	0.4	14.7	8.4	22.7	20.9	15.4	16.6
China	Shanghai Jahwa	600315.CN	88	63.6	50.1	35.6	21.4	1.9	12.5	16.4	17.1	16.4	20.2	22.5
	L'occitane	973.HK	21	33.0	28.7	23.3	12.2	1.9	22.8	16.0	22.8	16.0	31.7	22.5
Average				**28.8**	**23.9**	**19.9**	**12.8**	**1.0**	**9.8**	**8.0**	**16.1**	**15.2**	**21.4**	**21.3**

Note: Based on closing prices on November 4, 2010; Foreign company data based on Thomson estimates.
Source: Thomson, Korea Investment & Securities

Balance Sheet

Fiscal year ending Dec. (W bn)	2008A	2009A	2010F	2011F	2012F
Current assets	445	550	641	778	977
Cash & cash equivalents	137	195	239	332	487
Accounts receivable	109	114	129	143	157
Inventory	142	138	156	173	190
Fixed assets	1,010	1,114	1,253	1,299	1,342
Investments	149	144	162	180	198
Tangible assets	779	893	1,011	1,030	1,046
Intangible assets	24	29	32	36	39
Total assets	1,455	1,664	1,894	2,077	2,319
Current liabilities	199	217	245	272	299
Accounts payable	48	54	61	68	75
Short-term borrowings	0	0	0	0	0
Current portion of LT debt	0	0	0	0	0
Long-term debt	140	147	166	184	203
Debentures	0	0	0	0	0
Long-term borrowings	0	0	0	0	0
Total liabilities	340	364	411	456	502
Paid-in capital	35	35	35	35	35
Capital surplus	713	713	713	713	713
Capital adjustments	(1)	(2)	(70)	(232)	(391)
Retained earnings	339	530	781	1,081	1,437
Shareholders' equity	1,115	1,300	1,483	1,621	1,818

Income Statement

Fiscal year ending Dec. (W bn)	2008A	2009A	2010F	2011F	2012F
Sales	1,531	1,769	1,995	2,215	2,436
Gross profit	1,066	1,261	1,424	1,575	1,732
SG&A expenses	811	960	1,064	1,165	1,266
Operating profit	255	301	359	410	465
Non-op. profit	35	33	36	47	66
Interest income	13	9	16	21	28
FX gains	5	3	1	1	1
Equity gains	2	10	14	21	33
Non-op. expenses	46	35	12	10	10
Interest expenses	0	0	0	0	0
FX losses	3	3	2	2	2
Equity losses	35	15	3	0	0
Earnings before tax	244	299	383	447	521
Income taxes	74	73	94	110	128
Profit from discontinued op.	0	0	0	0	0
Net profit	170	226	289	338	394
EBITDA	318	374	441	498	558

Cash Flow

Fiscal year ending Dec. (W bn)	2008A	2009A	2010F	2011F	2012F
C/F from operations	238	330	362	402	450
Net profit	170	226	289	338	394
Depreciation	57	65	71	76	79
Amortization	6	9	10	12	13
Net incr. in W/C	(49)	4	(25)	(25)	(25)
Others	54	27	17	1	(11)
C/F from investing	(172)	(238)	(223)	(120)	(110)
Capex	(197)	(193)	(193)	(100)	(100)
Decr. in fixed assets	10	7	7	7	7
Net incr. in current assets	46	(41)	(11)	(10)	(10)
Incr. in investment	(15)	(5)	(8)	3	15
Others	(15)	(6)	(19)	(20)	(22)
C/F from financing	(35)	(35)	(95)	(189)	(185)
Incr. in equity	0	0	0	0	0
Incr. in debt	0	0	(0)	(0)	(0)
Dividends	(35)	(35)	(38)	(38)	(38)
Others	0	0	(57)	(151)	(147)
Increase in cash	32	58	45	93	155

Key Financial Data

Fiscal year ending Dec.	2008A	2009A	2010F	2011F	2012F
Per-share data (won)					
EPS	28,225	37,658	48,489	56,812	66,384
BPS	157,918	183,966	210,338	229,797	257,819
DPS	5,000	5,500	5,500	5,500	5,500
SPS	248,476	288,339	289,258	321,083	353,087
Growth (%)					
Sales growth	12.8	15.5	12.8	11.0	10.0
OP growth	2.6	17.8	19.5	14.0	13.6
NP growth	(4.3)	32.7	28.0	16.8	16.6
EPS growth	(4.4)	33.4	28.8	17.2	16.8
EBITDA growth	4.9	17.6	17.7	12.9	12.1
Profitability (%)					
OP margin	16.7	17.0	18.0	18.5	19.1
NP margin	11.1	12.8	14.5	15.3	16.2
EBITDA margin	20.8	21.2	22.1	22.5	22.9
ROA	12.5	14.5	16.3	17.0	17.9
ROE	16.5	18.7	20.8	21.8	22.9
Dividend yield	0.8	0.6	0.5	0.5	0.5
Stability					
Net debt (W bn)	(178)	(277)	(333)	(436)	(601)
Int. coverage (x)	NM	NM	NM	NM	NM
D/E ratio (%)	0.0	0.0	0.0	0.0	0.0
Valuation (x)					
PER	23.2	24.8	22.1	18.8	16.1
PBR	4.1	5.1	5.1	4.7	4.2
PSR	2.6	3.2	3.7	3.3	3.0
EV/EBITDA	11.9	14.7	14.1	12.3	10.7

■ **Guide to Korea Investment & Securities Co., Ltd. stock ratings based on absolute 12-month forward share price performance**

- BUY: Expected to give a return of +15% or more
- Hold: Expected to give a return between -15% and 15%
- Underweight: Expected to give a return of +15% or less

■ **Guide to Korea Investment & Securities Co., Ltd. sector ratings for the next 12 months**

- Overweight: Recommend increasing the sector's weighting in the portfolio compared to its respective weighting in the Kospi (Kosdaq) based on market capitalization.
- Neutral: Recommend maintaining the sector's weighting in the portfolio in line with its respective weighting in the Kospi (Kosdaq) based on market capitalization.
- Underweight: Recommend reducing the sector's weighting in the portfolio compared to its respective weighting in the Kospi (Kosdaq) based on market capitalization.

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