

12M rating **BUY (Initiate)**

12M TP **₩27,000**

Up/downside **+24%**

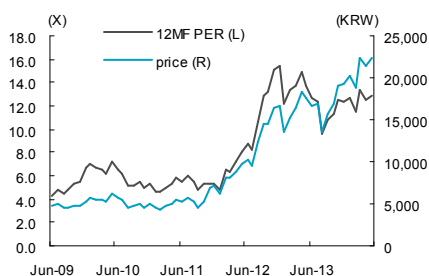
Stock Data

KOSPI (May 19, pt)	2,015
Stock price (May 19, KRW)	22,300
Market cap (USD mn)	873
Shares outstanding (mn)	40
52-Week high/low (KRW)	22,750/13,500
6M avg. daily turnover (USD mn)	2.4
Free float / Foreign ownership (%)	40.5/6.1
Major shareholders (%)	
Hansae Yes24 Holdings and 17 others	58.6
National Pension Service (NPS)	11.3

Performance

	1M	6M	12M
Absolute (%)	(2.5)	22.4	30.1
Relative to KOSPI (%p)	(3.5)	22.0	28.7

12MF PE trend



Source: WISEfn consensus

Make in SEA, sell in adv. markets

Initiate coverage with BUY and TP ₩27,000

We initiate our coverage of Hansae with BUY and a TP of ₩27,000 by applying a target 15x average 2014-2015F PE. Hansae, an apparel original equipment manufacturer (OEM), has a global customer pool of low/mid-priced casual fashion firms such as Gap, Walmart and H&M. It generates more than 90% of sales from the Americas and manufactures 60% of products in Vietnam, 25% Indonesia and 15% Central America. Although the company suffered as ASP fell and earnings were poor at overseas subsidiaries from 2H12, it is rapidly getting back to normal with an ongoing turnaround.

Favorable operating environment: SE Asia to stay competitive

Southeast Asia will continue to hold a competitive edge as an apparel OEM base. As China, which accounts for 40% of global apparel exports, is losing appeal due to soaring labor costs, Bangladesh and Vietnam are emerging as competitive production areas. While earnings and valuations differ among OEMs in Asia, it can be briefly described as a de-rating of mega-vendors based in China versus a re-rating for apparel OEMs located in Southeast Asia. As an apparel OEM with the largest reliance on Vietnam in its production breakdown, we believe Hansae's competitive edge will continue to be highlighted.

Turnaround after stagnant two years; EPS to rise 48% in 2014F and 25% in 2015F

Along with re-rating apparel OEM stocks in Southeast Asia, Hansae also jumped in 2011 and 2012. The stock should continue to appeal as favorable earnings momentum has resumed. EPS is set to climb 48% in 2015F and 25% in 2015F. Despite gradual KRW appreciation, the company should easily achieve three-year sales CAGR of 12% thanks to growing orders from existing customers, adding new clients (mainly fast fashion firms) and bigger capacity in Vietnam. As costs to add capacity in 2013 were already reflected and one-off losses are dwindling at overseas subsidiaries, OPM should bottom out from 4.8% in 2013 and improve to 6.1% in 2014F and further to 6.7% in 2015F.

	2012A	2013A	2014F	2015F	2016F
Sales (₩ bn)	1,130	1,238	1,368	1,530	1,729
OP (₩ bn)	63	60	83	103	117
EBT (₩ bn)	71	59	83	104	119
NP of con. int. (₩ bn)	53	43	63	79	90
EBITDA (₩ bn)	73	72	97	119	134
Net debt (₩ bn)	81	103	96	82	62
OP margin (%)	5.6	4.8	6.1	6.7	6.8
ROE (%)	24.9	16.8	21.0	21.6	20.4
Dividend yield (%)	0.7	0.8	0.8	0.8	0.9
EPS (KRW)	1,316	1,065	1,578	1,967	2,254
chg. (% YoY)	6.0	(19.1)	48.1	24.7	14.6
BPS (KRW)	5,856	6,802	8,212	10,002	12,068
DPS (KRW)	120	150	170	180	190
PE (x)	12.6	18.2	14.1	11.3	9.9
PB (x)	2.8	2.9	2.7	2.2	1.8
EV/EBITDA (x)	10.2	12.2	10.2	8.2	7.1

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Initiate with BUY and TP W27,000

We initiate our coverage of Hansae with BUY and a TP of W27,000 by applying a target 15x average 2014-2015F PE. The target multiple is in line with Youngone Corp., another apparel OEM. Hansae has a global customer pool of low/mid-priced casual apparel firms such as Gap, Walmart and H&M. It manufactures 60% of products in Vietnam, 25% Indonesia and 15% Central America. With the ASP drop stemming from a sharp decline in raw cotton prices and sluggish overseas subsidiary earnings from 2H12, the company saw consecutive OP contraction in 2012 and 2013. But since 4Q13, a turnaround is ongoing.

Table 1. Hansae

Overview	Note
Customer	~35 customers; Top seven buyers including Gap, Old Navy, American Eagle and Walmart account for more than 80% of sales; New customers include H&M, Zara, Uniqlo, Benetton and Under Armour
Sales by region	Generates more than 90% of sales from the Americas
Production by region	Vietnam (60%), Indonesia (25%), Central America (15%)
Work force	Vietnam (18,000 people), Indonesia (8,500), Guatemala (1,500), Nicaragua (3,000)
No. of lines	~500 lines
In-house production/subcontract	In-house production 60% vs. subcontract 40%
Products	Knitwear 84%, woven fabrics 16%
ASP	Avg. USD4/pcs for knitwear, USD7-8/pcs for woven fabrics
Cost breakdown	Raw materials 50%, labor 30%, overhead 20%
Main material	Raw cotton-based fabrics for wide use
USD net exposure	~23% of sales
Future strategy	Product mix improvement: Top and bottom-line improvement by expanding the woven business; Broader customer pool; Concentration on high-margin buyers by halting business with low-margin buyers; Fashion retail for infant/children's wear under the brand name Dreamsc
Capacity expansion	With capacity addition in Vietnam, Hansae's production (excl. subcontract) grew 25% from end-2012 to end-2013 and should expand 50% through end-2014

Source: Company data, Korea Investment & Securities

Favorable operating environment: SE Asia to stay competitive

China and Hong Kong together account for 43% of global apparel exports compared to 4.7% for Bangladesh, 3.3% for Vietnam and 1% each for Indonesia and Cambodia. Southeast Asia has emerged as a competitive production base, an alternative to China where labor costs have ballooned. Bangladesh and Vietnam have achieved a five-year trailing apparel export CAGR of 18% and 14%, respectively. Furthermore, Asian OEM earnings and valuations differ, which can briefly be described as

sluggish mega-vendors based in China versus sound apparel OEMs with USD700mn-USD1bn in sales and located in Southeast Asia. In that sense, OEMs such as Youngone Corp. (Youngone) and Hansae of Korea and Eclat and Makalot of Taiwan deserve attention.

Taiwan's Makalot most closely resembles Hansae. Makalot is an OEM for low to mid-end brands such as Gap and H&M and bases its production in Southeast Asia. Makalot's sales are half of Hansae's but they have a similar market cap due to Makalot's 9-10% OPM. Youngone is a comparable rival at home. Unlike Hansae, Youngone's customers are centered on outdoor and functional clothing and it achieves a ~15% OPM. But both have honed a competitive edge by running production in Vietnam and Bangladesh that have emerged as hotspots in the global apparel export market.

Table 2. Five rising stars in Asia's apparel OEM market

	(USD mn, x, %)				
	Hansae	Makalot	Youngone	Eclat	Shenzhou
Mkt cap (USD mn)	853	852	1,853	2,628	4,990
PE	5.7	10.1	9.7	8.2	6.2
	2012	12.6	12.6	11.3	14.0
	2013	18.2	20.1	16.9	30.8
	2014F	14.1	14.7	13.7	22.3
	2015F	11.3	12.1	10.3	16.4
PB	2011	1.5	2.6	2.1	2.2
	2012	2.8	3.2	2.1	4.0
	2013	2.9	5.1	2.2	10.4
	2014F	2.7	4.3	2.0	7.4
	2015F	2.2	4.0	1.7	6.1
EV/EBITDA	2011	4.2	6.0	5.0	6.2
	2012	10.1	7.1	5.9	10.2
	2013	12.3	15.2	9.4	22.9
	2014F	10.2	11.0	7.8	16.2
	2015F	8.2	9.0	5.8	11.9
ROE	2011	29.7	27.1	23.2	29.2
	2012	24.9	25.9	20.0	32.5
	2013	16.8	26.9	14.8	37.3
	2014F	20.7	31.2	15.3	41.1
	2015F	21.4	35.2	17.4	45.0
OPM	2011	7.3	9.6	18.4	13.6
	2012	5.6	9.6	17.6	16.5
	2013	4.8	9.1	14.5	18.1
	2014F	6.0	10.2	15.6	18.6
	2015F	6.6	10.9	17.7	19.6
EPS	2011	16.0	25.4	61.0	66.0
growth	2012	6.0	3.0	1.4	44.5
	2013	(19.1)	11.4	(13.6)	45.7
	2014F	45.7	26.6	26.4	27.6
	2015F	24.9	21.3	32.9	36.0
Sales	2011	898	515	894	362
	2012	1,002	537	940	459
	2013	1,167	603	1,045	611
	2014F	1,289	708	1,189	766
	2015F	1,442	832	1,404	986

Source: Bloomberg, Korea Investment & Securities

Earnings improvement to resume; Three-year EPS CAGR of 28%

EPS should expand 48% in 2014F and 25% in 2015F. OPM is pegged to improve from 4.8% in 2013 to 6.1% in 2014F and further to 6.7% in 2015F.

Table 3. Quarterly/annual earnings (W bn, %)

	1Q13	2Q13	3Q13	4Q13	1Q14F	2Q14F	3Q14F	4Q14F	2013	2014F	2015F
Sales	278	282	364	315	307	306	408	347	1,238	1,368	1,530
Change	12.0	12.4	1.1	16.2	10.4	8.5	12.0	10.4	9.6	10.4	11.9
OP	12	7	28	13	17	13	34	19	60	83	103
Change	(17.0)	(56.5)	(3.3)	257.2	43.2	78.3	21.8	50.7	(5.2)	39.0	23.6
OP margin	4.4	2.5	7.6	4.1	5.7	4.1	8.3	5.6	4.8	6.1	6.7
EBT	10	3	35	12	18	13	34	19	59	83	104
Change	(36.4)	(78.2)	11.4	18.8	79.9	323.1	(3.7)	63.4	(15.7)	40.0	24.7
EBT margin	3.5	1.1	9.6	3.7	5.8	4.2	8.2	5.5	4.8	6.1	6.8
NP	7	1	27	8	13	10	25	14	42	63	79
Change	(41.6)	(89.3)	5.6	30.5	91.8	871.2	(5.0)	89.6	(19.3)	48.7	24.7
NP margin	2.5	0.4	7.4	2.4	4.4	3.2	6.2	4.2	3.4	4.6	5.1

Source: Company data, Korea Investment & Securities

The company's separate and subsidiary earnings were announced in Hansae Yes24 Holdings' 1Q14 report. In the quarter, Hansae's separate sales added 12% YoY and NP swelled 68% YoY. Affiliate losses narrowed YoY. It was largely due to fewer one-off losses at the Indonesian subsidiary and a lower KRW/USD. Although losses continued at the Vietnam subsidiary that is still in the investment phase, it should contribute to better margins through 2015 once normal operations commence.

Three-year sales CAGR of 12% likely

We project three-year sales CAGR of 12% and 2016F sales of W1.7tn. We focus on 1) mounting orders from clients that operate key brand specialty stores and 2) customer additions such as fast fashion brands. The company is responding to wide-ranging demand by expanding shipments for the same orders and widening the product lineup from knitwear to woven products. A notable feature of the growing client list is the appearance of fast fashion brands. Starting with orders from H&M in 2011, Hansae began selling to more of the kind such as Zara in 2012 and Uniqlo in 2013. Combined orders from fast fashion brands jumped from USD10mn in 2011 to ~USD100mn in 2014F and became a main contributor to Hansae's sales growth. Although deals with fast fashion clients offer slim margins, they are replacing customers with margins far below average. Moreover, fast fashion orders could gradually contribute to better profitability through economies of scale.

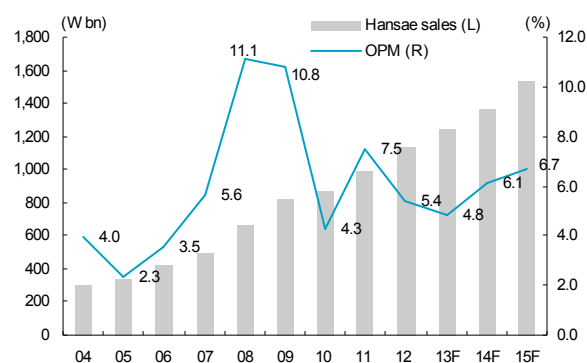
Hansae is adding capacity along with rising demand. To respond to Vietnam's mounting apparel OEM

demand, the company established new subsidiary TG in the country and began operations from 1Q13. Hansae added 110 production lines to the existing 400 at end-2012 for a 25% increase. Since the subsidiary can accommodate up to 198 additional lines, ~50% capacity addition is likely compared with end-2012. Around 50 lines commenced operations in 2013 and all 110 lines should shift into top gear this year.

Profitability erosion over past two years but OPM to steadily improve

Hansae's profitability kept falling after a peak in 1H12 due mainly to 1) lower ASP on a sharp drop in raw cotton prices, 2) losses stemming from capacity additions and 3) one-off losses at overseas subsidiaries. Of note, labor and transportation costs attributed to capex and aggressive volume order-taking were tough but these issues are fast being addressed of late. We peg 2014F OP to grow 39% YoY on 1) a modest ASP increase, 2) better productivity and 3) the elimination of one-off losses. From a mid-term perspective, we see profitability improving a notch on 1) a better mix of products and buyers and 2) economies of scale.

Figure 1. OPM to enter 6% level in 2014-2015



Source: Company data, Korea Investment & Securities

Specifically, there is an increase in the portion of brand-name buyers led by specialty stores that are more profitable than big-box retailers. Specialty stores such as Gap and Old Navy that feature a high ASP accounted for 37% of sales in 2006 and 49% in 2009, and they now represent more than 60%. Second, the portion of woven products with more than 30% higher ASP is also rising for major buyers. Hansae plans to lift the weighting of woven products from 17% in 2013 to 25% in 2014 and afterward to as much as 35%. Since 2011, Hansae has been beefing up woven products in its lineup in addition to the existing knitwear. The company switched subsidiary no. 1 in Vietnam to a woven factory, which has now resulted in a 73% increase in woven capacity compared to end-2011. Third, Hansae should be able to enhance

efficiency by not only enjoying operating leverage but trimming fabric purchase costs thanks to economies of scale. Specifically, Hansae would enjoy greater volume per order, volume fabric purchasing and narrower broking commissions on tighter direct dealing with buyers.

Risk factor: Gradual KRW appreciation

The KRW's appreciation of late is a concern for the company. If we assume the average KRW/USD for 2014 at W1,051, the company's net USD exposure would range 20-25%. If we peg it at 23%, every 1% drop in the KRW/USD would shrink its OP by 4.7%. But given the USD-denominated debt close to USD100mn, NP would fall by ~2% for every 1% drop in the KRW/USD. Factors that would ease the impact of a strong KRW include the time gap between the purchase and input of raw/intermediate materials, stronger value of local currencies in Vietnam and Indonesia against the USD and better productivity.

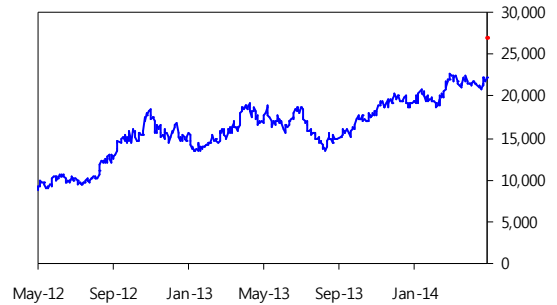
Company overview & Glossary

Hansae was established as a split entity from Hansae Yes24 Holdings on January 1, 2009. The company is a dedicated exporter of apparel as an original equipment manufacturer, dealing with big-name US buyers. It mainly produces shirts, knits, women's suits and casual apparel and exports to overseas buyers, such as Abercrombie & Fitch, American Eagle, Gap, Nike, Old Navy, Target, Victoria's Secret and Walmart.

- Original equipment manufacturer (OEM): Provide finished products under the brand name requested by the purchasing company

Changes to recommendation and price target

Company (Code)	Date Recommendation	Price target
(105630)	05-19-14	BUY W27,000



Balance sheet

FY-ending Dec. (W bn)	2012A	2013A	2014F	2015F	2016F
Current assets	398	450	530	605	692
Cash & cash equivalents	20	32	68	99	147
Accounts & other receivables	74	80	88	99	112
Inventory	145	163	180	202	228
Non-current assets	188	233	265	299	333
Investment assets	84	103	114	127	144
Tangible assets	77	95	112	129	140
Intangible assets	7	8	9	10	12
Total assets	586	682	794	904	1,025
Current liabilities	302	338	371	406	440
Accounts & other payables	54	56	62	69	78
ST debt & bonds	222	248	274	300	326
Current portion of LT debt	1	3	3	3	3
Non-current liabilities	50	72	95	99	104
Debentures	0	0	0	0	0
LT debt & financial liabilities	22	42	62	62	62
Total liabilities	351	410	466	505	545
Controlling interest	234	272	328	400	483
Capital stock	20	20	20	20	20
Capital surplus	48	48	48	48	48
Capital adjustments	(0)	(0)	(0)	(0)	(0)
Retained earnings	173	212	268	339	422
Minority interest	0	0	0	0	0
Shareholders' equity	234	272	329	400	483

Cash flow

FY-ending Dec. (W bn)	2012A	2013A	2014F	2015F	2016F
C/F from operations	41	27	58	72	78
Net profit	53	42	63	79	90
Depreciation	9	11	12	14	16
Amortization	1	1	1	1	2
Net incr. in W/C	(19)	(31)	(21)	(25)	(34)
Others	(3)	4	3	3	4
C/F from investing	(73)	(60)	(61)	(59)	(48)
Capex	(22)	(24)	(31)	(32)	(28)
Decr. in fixed assets	0	1	1	1	1
Incr. in investment	(50)	(30)	(11)	(13)	(16)
Net incr. in intangible assets	(0)	(0)	(2)	(3)	(3)
Others	(1)	(7)	(18)	(12)	(2)
C/F from financing	27	45	39	19	18
Incr. in equity	0	0	0	0	0
Incr. in debt	30	50	46	26	26
Dividends	(4)	(5)	(6)	(7)	(7)
Others	1	0	(1)	0	(1)
C/F from others	(1)	(1)	0	0	0
Increase in cash	(7)	12	37	32	49

Note: K-IFRS (consolidated)

Income statement

FY-ending Dec. (W bn)	2012A	2013A	2014F	2015F	2016F
Sales	1,130	1,238	1,368	1,530	1,729
COGS	906	1,010	1,104	1,230	1,390
Gross profit	223	228	264	300	339
SG&A expenses	160	168	181	197	222
Operating profit	63	60	83	103	117
Financial income	7	7	9	11	13
Interest income	7	7	9	11	13
Financial expenses	6	5	6	7	8
Interest expenses	6	5	6	7	8
Other non-operating profit	7	(2)	(3)	(3)	(3)
Gains (Losses) in associates, subsidiaries and JV	0	0	0	0	0
Earnings before tax	71	59	83	104	119
Income taxes	18	17	20	25	29
Net profit	53	42	63	79	90
Net profit of controlling interest	53	43	63	79	90
Other comprehensive profit	(3)	0	0	0	0
Total comprehensive profit	50	43	63	79	90
Total comprehensive profit of controlling interest	50	43	63	79	90
EBITDA	73	72	97	119	134

Key financial data

FY-ending Dec.	2012A	2013A	2014F	2015F	2016F
Per-share data (KRW)					
EPS	1,316	1,065	1,578	1,967	2,254
BPS	5,856	6,802	8,212	10,002	12,068
DPS	120	150	170	180	190
Growth (%)					
Sales growth	13.5	9.6	10.4	11.9	13.0
OP growth	(13.6)	(5.2)	39.0	23.6	13.8
NP growth	6.0	(19.1)	48.1	24.7	14.6
EPS growth	6.0	(19.1)	48.1	24.7	14.6
EBITDA growth	(8.9)	(2.1)	34.8	22.6	13.3
Profitability (%)					
OP margin	5.6	4.8	6.1	6.7	6.8
NP margin	4.7	3.4	4.6	5.1	5.2
EBITDA margin	6.5	5.8	7.1	7.7	7.8
ROA	9.6	6.7	8.5	9.3	9.3
ROE	24.9	16.8	21.0	21.6	20.4
Dividend yield	0.7	0.8	0.8	0.8	0.9
Stability					
Net debt (W bn)	81	103	96	82	62
Debt/equity ratio (%)	104.3	107.5	103.1	91.1	80.9
Valuation (x)					
PE	12.6	18.2	14.1	11.3	9.9
PB	2.8	2.9	2.7	2.2	1.8
PS	0.6	0.6	0.7	0.6	0.5
EV/EBITDA	10.2	12.2	10.2	8.2	7.1

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- 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
- Korea Investment & Securities does not offer target prices for stocks with Hold or Underweight ratings.

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- 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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