Korea Investment & Securities Co., Ltd.

Company Note
October 24, 2013

Cosmax (044820)

Uncertainty over holding company structure resolved, earnings also favorable

12M rating	**BUY (Maintain)**
12M TP	**W61,000** *from W61,000*
Up/downside	**+27%**

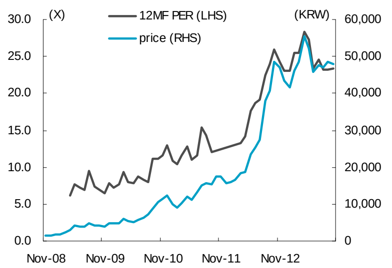
Stock Data

KOSPI (Oct 23, pt)	2,036
Stock price (Oct 23, KRW)	47,850
Market cap (USD mn)	616
Shares outstanding (mn)	14
52-Week high/low (KRW)	56,500/38,500
6M avg. daily turnover (USD mn)	6.2
Free float / Foreign ownership (%)	75.3/22.2
Major shareholders (%)	
Gyeong-Su Lee and 4 others	23.5
National Pension Service (NPS)	11.6

Performance

	1M	6M	12M
Absolute (%)	1.1	(13.6)	(0.9)
Relative to KOSPI (%p)	(0.3)	(19.7)	(6.6)

12MF PE trend



Source: WISEfn consensus

Announced transition to holding company structure via spin-off

During trading hours on October 23, Cosmax announced it would adopt a holding company structure via spin-off. Through the spin-off (0.338:0.662 ratio), Cosmax Bio (health supplement food) will become a holding company (remaining entity), and the domestic and overseas businesses (parent and overseas subsidiaries, including China) will comprise the operating company (new entity) (Figure 2). Cosmax has yet to announce detailed plans to satisfy holding company requirements (investment in-kind of the largest shareholder and equity swap). However, follow-up measures are likely to be carried out next year after the re-listing on April 7, 2014. Of note, the holding company may acquire a 23.8% stake in the operating company and the major shareholder may acquire a 59.5% stake in the holding company through the holding company's new shares issuance (89.4% to existing shares outstanding) assuming the same equity swap ratio as the spin-off.

Core subsidiaries included in operating company, uncertainty over transition resolved

Adopting a holding company structure in and of itself is neutral to the overall company value. However, it is positive that uncertainty over the transition structure, which mounted since inquiry notice about rumor of transition to a holding company at end-August, has been resolved. The operating company will secure the overseas cosmetics subsidiaries, the core variable for further valuation. As such, there should be no problems with the transfer of core subsidiaries to the holding company as in Korea Kolmar or Donga Pharm's cases. In terms of the operating company, it is negative that the high-margin and high-growth structured Cosmax Bio will be transferred to the holding company, but the operating company is sufficiently attractive given the overseas cosmetics expansion momentum. The main purpose of the transition is to reinforce managerial rights by expanding the stake of the major shareholders. In addition, small- to medium- sized companies are stepping up the drives for holding company transition, which is not irrelevant with uncertainties regarding extension of the law to defer tax on capital gains on stock transfer into 2014 and beyond.

Focus on fundamentals: High OP growth in 3Q13F, China/overseas business smoothly progressing

We recommend focusing on operating fundamentals as holding company uncertainties have been resolved. 3Q13 OP should beat our previous estimate by 14% (sales W91.9bn, 18% YoY, OP W7bn, 19.3% YoY). We had expected a lower

Yr to Dec	Sales (W bn)	OP (W bn)	EBT (W bn)	NP (W bn)	EPS (won)	% chg (YoY)	EBITDA (W bn)	PE (x)	EV/EBITDA (x)	PB (x)	ROE (%)
2011A	244	17	14	12	855	9.7	22	18.4	12.4	3.5	20.9
2012A	313	26	24	20	1,523	78.1	32	28.4	20.8	7.6	29.8
2013F	380	30	29	24	1,774	16.5	37	27.0	20.4	6.8	27.7
2014F	481	44	42	35	2,569	44.8	52	18.6	14.6	5.2	31.5
2015F	605	59	57	47	3,513	36.8	67	13.6	11.3	3.9	32.6

Note: Net profit and EPS are based on figures attributed to controlling interest

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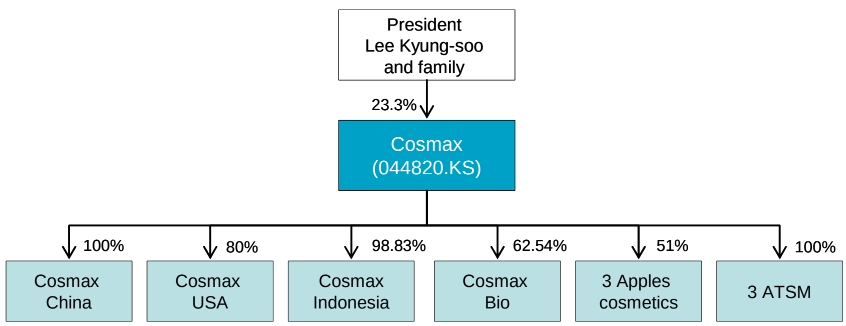
OP given initial operating costs for overseas factories (W750mn) and costs for facility relocation at Cosmax Bio (W1bn). However, earnings should be strong as a favorable domestic cosmetics business should generate economies of scale, offsetting the cost burden at new factories, while costs for facility relocation have been deferred to 4Q13. Meanwhile, the global ODM export business is making smooth progress, in addition to high growth at the Chinese subsidiary. Cosmax has already supplied to over 20 global premium branded companies, though the initial order amounts were relatively small. Over the long term, the sales contribution of exports to the parent sales should increase from the current ~10% to 20% by 2017.

Maintain as top pick on strong earnings and accelerating overseas momentum in 2014

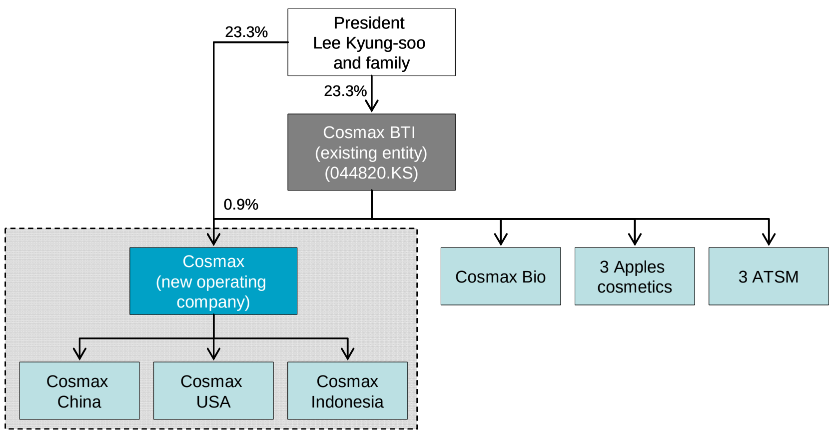
We maintain Cosmax as our top pick with a TP of W61,000 (27x 12MF EPS, 10% discount to historical peak) reflecting the strong 3Q13F earnings outlook and structural mid- to long- term growth story overseas.

Figure 1. Cosmax's ownership structure (pre spin-off)



Source: Company data, Korea Investment & Securities

Figure 2. Cosmax's ownership structure (post spin-off)



Source: Company data, Korea Investment & Securities

Table 1. Financial statements post spin-off

(W bn, %)

	Pre spin-off (W bn)	Post spin-off (W bn)		Post spin-off (%)	
	Cosmax	Cosmax BTI (remaining company)	Cosmax (new operating company)	Cosmax BTI (surviving company)	Cosmax (new operating company)
Total assets	**215**	**37**	**178**	**17.4**	**83.0**
Current assets	129	22	107	17.2	82.8
Cash & cash equivalents	12	9	3	75.5	24.5
Current financial assets	25	13	12	52.3	47.7
Non-Current Assets	86	15	72	17.7	83.3
Investments in associates/subsidiaries	28	10	18	35.6	64.4
Tangible assets	48	2	46	4.2	95.8
Total liabilities	**142**	**13**	**130**	**8.9**	**91.4**
Short-term borrowings	33	3	30	9.0	91.0
Long-term borrowings	39	8	31	19.4	80.6
Shareholder's equity	**73**	**25**	**49**	**33.8**	**66.8**
Capital stock	7	2	4	33.8	66.2
Retained earnings	16	(28)	44	NM	268.7

Source: DART, Company data

Table 2. Cosmax spin-off schedule

Date	Contents
23-Oct-13	Decision of split
29-Jan-14	Shareholders' meeting for approval
1-Mar-13	Spin-off
27-Feb-14 – 6-Apr-14	Trading suspension period
7-Apr-14	Holding company: Date of relisting, Operating company: Date of new listing
7-Apr-14 – 31-Dec-15	Investment in kind (scheduled)

Source: DART, Company data

Company overview & Glossary

Cosmax was established in Nov 1992 for cosmetics manufacture and sales. Cosmax currently take the second place on sales amount base in Korean cosmetics OEM/ODM market among over 200 competitors. In 2012, Cosmax was chosen as the best cooperation partner of the global brand Loreal group. There are Cosmax China (amount to 16.8% of total consolidated sales as of 2011A) and Iljin Pharm (health functional food business, amount to 16.8% of total consolidated sales as of 2011A)

- ODM (Original Development Manufacturing): Provide total service from product design, development to production

Balance sheet

FY-ending Dec. (W bn)	2011A	2012A	2013F	2014F	2015F
Current assets	101	120	154	195	245
Cash & cash equivalent	10	9	19	24	30
Accounts & other receivables	48	54	66	83	104
Inventory	36	42	51	65	82
Non-current assets	99	121	142	143	141
Investment assets	6	13	16	21	26
Tangible assets	88	103	119	114	104
Intangible assets	3	4	5	7	8
Total assets	199	242	296	338	386
Current liabilities	114	111	109	98	83
Accounts & other payables	54	52	63	80	101
ST debt & bond	55	53	53	48	38
Current portion of LT debt	2	2	3	4	4
Non-current liabilities	24	50	88	111	130
Debentures	0	0	0	0	0
LT debt & financial liabilities	15	40	75	95	110
Total liabilities	138	162	197	209	213
Controlling interest	60	77	95	124	166
Capital stock	7	7	7	7	7
Capital surplus	16	17	17	17	17
Capital adjustments	(5)	(5)	(5)	(5)	(5)
Retained earnings	39	56	76	107	151
Minority interest	1	3	4	5	7
Shareholders' equity	61	80	99	129	173

Income statement

FY-ending Dec. (W bn)	2011A	2012A	2013F	2014F	2015F
Sales	244	313	380	481	605
COGS	205	259	316	396	497
Gross profit	39	54	65	85	108
SG&A expense	22	28	35	41	49
Operating profit	17	26	30	44	59
Financial income	0	0	1	1	2
Interest income	0	0	1	1	2
Financial expense	3	5	6	7	7
Interest expense	3	5	6	7	7
Other non-operating profit	0	1	2	1	1
Gains (Losses) in associates, subsidiaries and JV	0	2	2	2	3
Earnings before tax	14	24	29	42	57
Income taxes	3	2	4	6	8
Net profit	11	22	25	36	49
Net profit of controlling interest	12	20	24	35	47
Other comprehensive profit	1	(2)	(2)	(2)	(2)
Total comprehensive profit	12	20	23	34	47
Total comprehensive profit of controlling interest	12	18	22	33	45
EBITDA	22	32	37	52	67

Cash flow

FY-ending Dec. (W bn)	2011A	2012A	2013F	2014F	2015F
C/F from operating	17	12	7	5	13
Net profit	11	22	25	36	49
Depreciation	4	6	6	7	8
Amortization	0	0	0	1	1
Net incr. in W/C	(6)	(22)	(24)	(39)	(45)
Others	8	6	0	0	0
C/F from investing	(32)	(33)	(29)	(12)	(8)
CAPEX	(29)	(38)	(40)	(20)	(15)
Decr. in fixed assets	0	18	18	18	18
Incr. in investment	(2)	(12)	(3)	(4)	(5)
Net incr. in intangible assets	(0)	(2)	(1)	(2)	(2)
Others	(1)	1	(3)	(4)	(4)
C/F from financing	22	21	32	12	2
Incr. in equity	0	0	0	0	0
Incr. in debts	24	23	36	16	6
Dividends	(3)	(3)	(4)	(4)	(4)
Others	1	1	0	0	0
C/F from others	0	(0)	0	0	0
Increase in cash	7	(1)	10	5	6

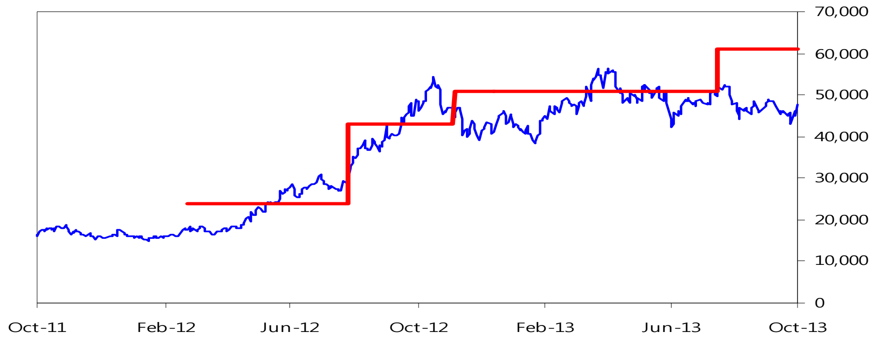
Note: Based on K-IFRS (consolidated)

Key financial data

FY-ending Dec.	2011A	2012A	2013F	2014F	2015F
per share data (KRW)					
EPS	855	1,523	1,774	2,569	3,513
BPS	4,482	5,726	7,066	9,194	12,257
DPS	200	270	270	270	270
Growth (%)					
Sales growth	19.8	28.1	21.6	26.5	25.7
OP growth	32.6	54.8	16.4	44.8	33.5
NP growth	13.5	78.0	16.6	44.8	36.8
EPS growth	9.7	78.1	16.5	44.8	36.8
EBITDA growth	33.5	47.6	16.1	38.9	30.3
Profitability (%)					
OP margin	6.9	8.4	8.0	9.2	9.7
NP margin	4.7	6.6	6.3	7.2	7.8
EBITDA margin	8.9	10.2	9.8	10.7	11.1
ROA	6.7	10.1	9.3	11.4	13.6
ROE	20.9	29.8	27.7	31.5	32.6
Dividend yield	1.3	0.6	0.6	0.6	0.6
Stability					
Net debt (W bn)	60	76	100	107	103
Debt/equity ratio (%)	118.9	119.0	132.0	113.2	88.0
Valuation (X)					
PER	18.4	28.4	27.0	18.6	13.6
PBR	3.5	7.6	6.8	5.2	3.9
PSR	0.9	1.9	1.7	1.4	1.1
EV/EBITDA	12.4	20.8	20.4	14.6	11.3

Changes to recommendation and price target

Company (Code)	Date	Recommendation	Price target
Cosmax (044820)	03-16-12	BUY	W24,000
	08-19-12	BUY	W43,000
	11-28-12	BUY	W51,000
	08-09-13	BUY	W61,000



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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
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  - 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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