

FILA Korea (081660)

12M rating **BUY (Maintain)**

12M TP **₩100,000** from ₩100,000

Up/downside **+28%**

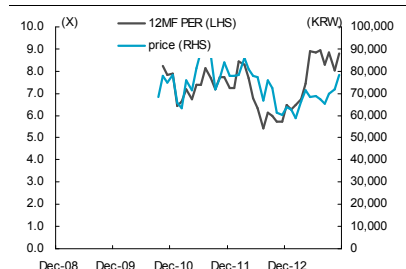
Stock Data

KOSPI (Nov 19, pt)	2,032
Stock price (Nov 19, KRW)	78,300
Market cap (USD mn)	737
Shares outstanding (mn)	10
52-Week high/low (KRW)	80,000/57,500
6M avg. daily turnover (USD mn)	2.3
Free float / Foreign ownership (%)	88.5/29.2
Major shareholders (%)	
Yun-Su Yoon and 5 others	11.5
Templeton Asset Management Ltd and 6 others	11.3

Performance

	1M	6M	12M
Absolute (%)	6.8	9.8	27.9
Relative to KOSPI (%p)	7.8	7.6	19.8

12MF PE trend



Source: WISEfn consensus

NDR takeaways: Collective efforts fuel brand power

Diversified profit engines, global brand value growth underway

On November 18-19, we held an NDR with FILA Korea for domestic investors as interest grows following solid earnings. Investors were focused on: 1) the catalysts for robust earnings in the US and the outlook, 2) changes in the royalty structure, 3) domestic margin growth factors, and 4) Acushnet's mid- to long-term outlook and accounting issues, including debt valuation losses. We believe earnings growth was not a temporary pickup, and results will continue to trend up. In addition, Acushnet maintained earnings and expanded global market share despite poor operating conditions. Acushnet earnings should grow in 2014. Meanwhile, shares trade at 10x 2014 diluted PE. We maintain BUY with a TP of ₩100,000 (13x 2014 PE).

3Q13 surprise, earnings to remain robust in 4Q13

Brisk results should continue in 4Q13 following the 3Q13 surprise. 4Q13 OP should surge 20% YoY to ₩29bn. While domestic sales should fall 8% YoY and OP 18% YoY, FILA USA sales should surge 23% YoY and turn to an operating profit, while royalty income should gain about 8% YoY. Operating losses at Acushnet should narrow from USD33mn in 4Q12 to USD8mn as incentive allowances improve. We believe the weighting of discounted domestic sales will decline, while new business sales contribution grows at FILA USA. Royalties should be favorable in North America and Europe.

Earnings trend up in US and Europe on growing competitiveness and synergies with distributors

Earnings in the US and Europe have been fueled by mid-price products and increasing synergies with major distributors. In the US, consumer spending is picking up, while competition is easing. Furthermore, the FILA brand name is growing due to its low prices and high product quality in the mid-priced market, backed by aggressive channel expansion. In particular, royalties in North America have grown 41% as of 3Q13 YTD backed by Kohl's apparel license sales and a normalizing shoe business. In addition, Kirkland PB brand sourcing sales at Costco accounted for 20% of sales in 3Q13, confirming the company's strength in shoe sourcing. While earnings visibility in the US is low due to wholesale orders and small economies of scale, FILA should continue to grow on growing brand competitiveness. Meanwhile, royalties from Europe grew 17% YTD. We attribute this to the 2011 change in licensee to a sports product distributor with the largest distribution network in Europe.

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Yr to	Sales	OP	EBT	NP	EPS	% chg	EBITDA	PE	EV/EBITDA	PB	ROE
Dec	(W bn)	(W bn)	(W bn)	(W bn)	(won)	(YoY)	(W bn)	(x)	(x)	(x)	(%)
2011A	764	109	3	2	237	(97.6)	117	327.8	8.8	2.4	0.7
2012A	670	91	147	121	12,423	5,141.8	101	5.2	8.7	1.5	33.2
2013F	729	103	48	36	3,657	(70.6)	112	21.4	9.2	1.7	8.3
2014F	792	118	126	95	9,561	161.5	128	8.2	7.7	1.4	19.0
2015F	848	130	146	111	11,141	16.5	139	7.0	6.9	1.2	18.5

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

China to fuel mid- to long-term growth: Acushnet and FILA brand

Concerns over growth momentum at Acushnet have emerged as YTD sales growth is only 1%. We attribute the minimal growth to bad weather in the US and Europe and a weak JPY against USD. However, all regions, excluding the US, are growing, and the company has performed well compared to peers. We expect Acushnet to reach its target EBITDA of USD180mn in 2013. Going forward, Acushnet should generate an EBITDA of USD210mn as the global golf market recovers and as costs are lowered by expanding capacity in Thailand. Growth in China is key to sales re-rating over the mid to long term. China is still in the early growth stages, and accounts for only 4-5% of sales, less than one-tenth that of the US and half that of Korea.

We see changes for the FILA brand in China. Operations in China were launched through a joint venture with Anta Sports (Full Prospect, 15% stake). In 2012, Full Prospect posted sales of W46bn and a W8bn operating loss. However, sales in China should top W90bn this year and the company should turn to a profit. Including design commissions (3% of sales) and dividends, FILA Korea should secure about W3.4bn in profit, excluding equity method gains. Full Prospect should continue to generate profit as China continues to grow.

FILA Korea domestic NDR Q&A summary

1. FILA Korea domestic division

Q. How did FILA Korea's domestic division improve sales and margins in 3Q13?

- 3Q13 OP jumped 67%, while sales improved only 2%
- This was mostly due to an increase in the full retail price sales weighting and a W1.2bn decline in ad costs; furthermore, department stores' discount sales and period are also shrinking
- Number of stores slipped 3% YoY in 3Q13; however, margins improved as poorly performing stores were shutdown

Q. FILA Korea's domestic division guidance in 4Q13

- 4Q sales growth target is 8-9%; however, it was only 2-3% in October. We conservatively estimate sales growth around 5%. In addition, we plan to market heavy down jackets aggressively. 4Q13 OP should improve more than 15%

2. FILA USA

Q. How did sales jump 70% YoY in 3Q?

1) FILA USA's shoe business grew 43% YoY as orders from major buyers continue to grow. Growing consumer popularity and easing competition were also major factors. Shoes functionality is similar to Nike and Adidas in terms of materials or shock absorption, while our prices are 50% lower. The market was also favorable. Retail orders were concentrated on existing brands due to the sale of K-Swiss, And1 and Avia, bolstering Skechers and FILA sales. We plan to closely monitor if this is an increase in wholesale demand or retailers preemptively securing volume. But with And1 and Avia already focusing on the low-priced market, particularly Wal-Marts, competition appears to be easing in the mid-priced market.

2) USD9.5mn sales were generated by expanding the retail PB brand sourcing business. USD8.5mn in sales from Costco was from Kirkland boots and shoes. NP improved sharply as 15% of sales was paid as commissions, and were reflected on the non-operating balance (K-IFRS basis) while there were no material effects

on gross profit as sales and COGS are reflected concurrently. Of note, the 15% commission is higher than 10% of competitors.

Retailers are strengthening PB brands amid weak operating conditions. We expect to secure other PB brand, in addition to Costco. Increasing sales should further reinforce our bargaining position. In addition, we are rapidly expanding our workforce at FILA Sport HK, which manages sourcing manufacturers.

Q. What is the strength in sourcing? Why are retailers working with FILA?

- The mid-priced channel, including Kohl's and JC Penny, is monitoring FILA due to the rapid sales growth in the US. FILA can provide products 20% cheaper than peers. We source products from Jinjiang rather than Dongjiang, which is the largest regional shoe manufacturing complex, for FILA USA products. There are currently about 800 sourcing companies in Jinjiang, and we have deals with about 300. China still accounts for about 70% of sourcing, but we plan to expand into Indonesia going forward.

Q. 4Q13 and 2014 guidance

- We lifted 2013 sales guidance to USD200-210mn from early USD170mn. Sales should grow about 20-30% in 4Q13 on new orders from Costco
 - Costs should depend on outsourcing expansion and incentives
 - 2014 sales should grow 10%. Early orders up to April 2014 are up 15% YoY

Q. FILA USA and shoe business outlook over mid to long term

- Currently, major US distribution channels are not focused on shoe retailers. We plan to expand into shoe stores, such as Foot Locker, which account for 60% of the total shoe market, by reinforcing our brand value over the mid to long term.
 - Given the regional trends, it is difficult to integrate all sportswear, and we plan to continue focusing on shoes going forward. We are currently building an R&D center in Busan, and have hired about 20 employees from Reebok and Asics.
 - FILA brand integration is underway. We plan to release a common global model next year, which should account for about 15% of shoe volume. And, we plan to increase licensee product sales, while buying through FILA HK.

3. Overseas royalties

Q. Overseas royalties, regional performance and company guidance

- Guidance released in early 2013 forecast a 7% gain in royalties, but we believe at present that full-year royalties will rise 10-11%. Licensees in the US/Canada performed well. USD-denominated royalties are up 41% YTD. With Kohl's accounting for 40% of royalties, it is a major buyer of FILA USA and a licensee of FILA apparel. Royalties from Europe, the Middle East and Africa (EMEA) are up 17% YTD. This is due mainly to changes in partnership to Deichmann, the biggest sportswear retailer in Europe.

- Royalties from Japan and South America are down, but this is attributed to a sharp rise in the JPY/USD (Japan, +26% YoY YTD) and the BRL/USD (Brazil). In terms of domestic currency, royalties from all licensees are trending upward.

- Even with minimum guarantees, royalties can achieve ~6% growth. There are no risks related to contract termination. Most contracts are long term, and even the short-term licensees in Russia, India and other countries want to change to long-term deals. As such, royalties are unlikely to decrease over the next decade.

4. FILA China business

Q. How is the China business progressing?

- The China business involves a joint venture called Full Prospect with Anta Sports. Anta Sports holds FILA brand rights in China, Hong Kong and Macau. FILA Korea owns a 15% stake in Full Prospect.
- Anta Sports has been aggressively expanding distribution channels. Stores increased from 280 as of end-2012 to 360 as of end-3Q13. The number may rise to 400-420 as of end-2013. It would be possible to add 80-100 stores annually. 3Q13 YTD sales are up 93% YoY. It made operating losses in 2012 but turned around in 3Q13 and erased losses from 1H13.
- FILA Korea books 3% of China sales as commission income. It also earns W700mn of dividends p.a. from China business. It should generate W3.4bn of profits from China in 2013F. Commission income was W1.3bn (China sales of W46bn) in 2012 and W2.7bn (W90bn) in 2013.

5. Acushnet

Q. What are the reasons behind disappointing growth in 2013?

1) Acushnet posted 1% YoY sales growth YTD. Weather conditions were extremely unfavorable in major markets, such as the US and Europe. The poor weather conditions delayed the opening of golf courses in the US and Europe by almost two months. As Acushnet's main products are non-durable items, such as golf balls, sales are closely correlated with the number of roundings. While sales were sound until 1Q13, growth slowed sharply since April.

2) Slowing consumption resulted in sluggish sales across the market (except Titleist and Taylormade) for the past three years. Massive discount sales by competitors stoked competition in 2013.

3) While Japanese sales account for more than 15% of total sales, a 26% rise in JPY/USD undermined sales in Japan. In JPY terms, sales grew more than 10% in the region.

- Nonetheless, Acushnet has expanded market share and recorded positive sales growth, which is unique for global golf brands. In 2013, Taylormade sales shrank 5% while Nike Golf and Callaway post double-digit sales declines.

- Acushnet's global market share stands at 58% in terms of golf balls, or 46% in terms of the overall golf products and accessories. Acushnet commands the biggest share of the world's golf product market, except golf clubs.

- By region, sales broke down into 56% the US, 17-18% Europe and ~25% Asia. While Japanese sales account for 17% of the total, Korea's represent half that of Japan. Chinese sales contribution is half of Korea's.

Q. Will slow top-line growth push down OP?

- Although 2013F sales should add 1% YoY, OP should expand more than 20% YoY, thanks to cost controls and promotion cost reduction. EBITDA stands at USD160mn YTD 2013, and the full annual figure will likely reach USD180mn.

Q. What are plans to improve future growth and profitability?

- For 2014F, target EBITDA is US\$210mn (+17% YoY).
- With a low comparison base, the global golf market should slightly improve in 2014. In fact, the US market has grown 4% p.a. except 2013.
- As capacity addition is completed at the Thai plant, cost reduction is anticipated. The plant should begin operation from 2014, and produce golf balls for the entire Asian market. Added capacity will likely save production costs of USD0.7-USD1 per ball. At present, Asia manufactures 10mn balls per year, and the figure is rising annually. Assuming exponential growth of China's golfing population (currently 2mn), the cost reduction effect should be even greater from a mid- to long-term perspective.
- The Thai plant was built to save logistics costs. Previously, the firm purchased raw materials in Malaysia, and manufactured products in the US and exported balls back to Asia. Still, the company will produce high added-value balls, such as the Pro v1 and Pro v1x, in the US to prevent technology leaks and to maintain the made-in-USA value.

Q. When will Acushnet go public? What preparations should follow? And, what will happen to the losses on valuations of liabilities if the company goes public?

- The IPO is scheduled for 2016. It is not an impossible job at present, but the company hopes to achieve a 2011-2015F EBITDA CAGR of 20% before it makes a stock market debut. It also plans to complete the repayment of debt worth USD500mn before the IPO. The target EV/EBITDA would be 10-12x with an EBITDA of USD240mn and an EV of USD2.5bn+ at the time of the IPO. We would have 33% of ownership along with managerial rights.
- In fact, before the IPO, financial investors gain most profits made by Acushnet in the form of a fixed interest rate of 7.5% and dividends. The presence of the liability valuation loss makes our financial statement less attractive. But, the loss is not actually meaningful. We have a call option, which gives us the right to buy Acushnet's warrant at the same price with the initial acquisition price every year. Accordingly, we have expanded our ownership over Acushnet by 4.2% every August, and the price for share accumulation is the same as when we first acquired the company in 2011.
- The loss on valuation of liabilities takes place in the process of measuring the value of investments that financial investors made in Alexandria Holdings, a holding company for Acushnet, in the form of convertible bonds (CB), bonds with warrants (BW) and redeemable convertible preferred stocks (RCPS). According to the evaluation of the liabilities' value (assuming conversion into shares), a rise in the value leads to a valuation loss. As such, bigger losses mean a higher EV for Acushnet. When the IPO takes place and the liabilities are converted into common stocks, the loss will no longer be booked. But, it is likely to persist until the IPO is executed.

Q. Acushnet's mid to long-term growth outlook

- People are developing a strong interest in golf in China. Acushnet had been posting 18-20% growth since the 2008 Summer Olympics, but growth slowed in 2013 due to tighter regulations on luxury goods. Nevertheless, it has been posting 9-10% growth. Given that this accounts for only 4% of sales, it contributes little to the top line.

■ Company summary

FILA Korea was established in 1991 and launched domestic sales under the brand name FILA from 1992. It split from the Fila Global Group through a management buyout (MBO) method and became a licensee with rights to use the FILA brand in 2005. In 2007, the global Fila brand and all its international subsidiaries were acquired by Fila Korea through takeover deals. It operates through licensees worldwide and receives royalty payments. In 2011, FILA Korea acquired top global golf equipment maker Acushnet Co. in a joint deal with the Mirae Asset Private Equity Fund.

Licensee: A counterparty to a licensor in a license agreement. The licensee is granted rights to patents, trademark rights and copyrights in return for royalty payments.

Balance sheet

FY-ending Dec. (W bn)	2011A	2012A	2013F	2014F	2015F
Current assets	324	292	281	306	323
Cash & cash equivalent	48	36	11	16	17
Accounts & other receivables	123	93	98	103	106
Inventory	131	138	146	158	170
Non-current assets	515	585	633	684	767
Investment assets	32	130	142	166	233
Tangible assets	43	45	45	45	45
Intangible assets	405	379	412	436	450
Total assets	839	877	914	990	1,090
Current liabilities	243	247	246	225	215
Accounts & other payables	89	83	90	98	105
ST debt & bond	126	86	66	46	26
Current portion of LT debt	0	53	53	43	33
Non-current liabilities	298	215	221	227	232
Debentures	57	0	0	0	0
LT debt & financial liabilities	176	152	152	152	152
Total liabilities	541	463	467	452	447
Controlling interest	309	422	455	545	651
Capital stock	47	50	50	50	50
Capital surplus	77	84	84	84	84
Capital adjustments	0	0	0	0	0
Retained earnings	167	285	318	408	514
Minority interest	(10)	(8)	(8)	(8)	(8)
Shareholders' equity	299	414	447	537	643

Cash flow

FY-ending Dec. (W bn)	2011A	2012A	2013F	2014F	2015F
C/F from operating	45	84	90	73	97
Net profit	1	122	36	95	111
Depreciation	8	9	9	9	9
Amortization	0	0	0	0	0
Net incr. in W/C	(40)	22	3	(13)	3
Others	76	(69)	42	(18)	(26)
C/F from investing	(118)	(48)	(93)	(35)	(61)
CAPEX	(11)	(11)	(9)	(9)	(9)
Decr. in fixed assets	0	0	0	0	0
Incr. in investment	(106)	(38)	(54)	(6)	(40)
Net incr. in intangible assets	(1)	(0)	(33)	(24)	(14)
Others	0	1	3	4	2
C/F from financing	97	(49)	(22)	(33)	(35)
Incr. in equity	0	9	0	0	0
Incr. in debts	106	(52)	(20)	(30)	(30)
Dividends	(5)	(2)	(2)	(3)	(5)
Others	(4)	(4)	0	0	0
C/F from others	1	0	0	0	0
Increase in cash	24	(12)	(25)	5	1

Note: Based on K-IFRS (consolidated)

Income statement

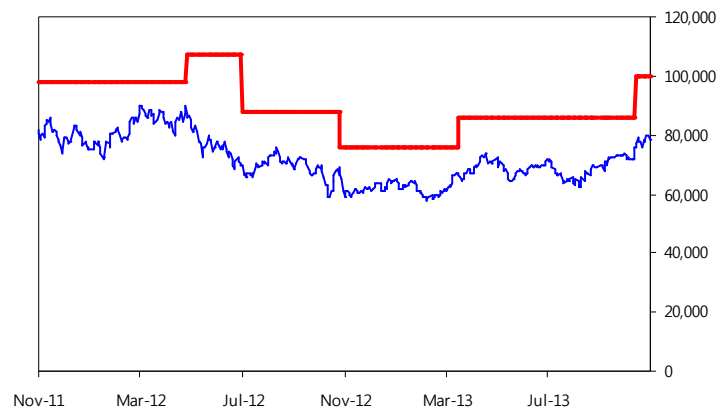
FY-ending Dec. (W bn)	2011A	2012A	2013F	2014F	2015F
Sales	764	670	729	792	848
COGS	379	322	362	391	417
Gross profit	386	348	367	401	432
SG&A expense	277	257	264	283	302
Operating profit	109	91	103	118	130
Financial income	39	42	1	1	1
Interest income	1	0	0	0	0
Financial expense	63	47	14	12	11
Interest expense	13	16	14	12	10
Other non-operating profit	(3)	(1)	0	0	0
Gains (Losses) in associates, subsidiaries and JV	(79)	61	(41)	19	27
Earnings before tax	3	147	48	126	146
Income taxes	2	25	12	30	35
Net profit	1	122	36	95	111
Net profit of controlling interest	2	121	36	95	111
Other comprehensive profit	(7)	(15)	0	0	0
Total comprehensive profit	(6)	107	36	95	111
Total comprehensive profit of controlling interest	(6)	107	36	95	111
EBITDA	117	101	112	128	139

Key financial data

FY-ending Dec.	2011A	2012A	2013F	2014F	2015F
per share data (KRW)					
EPS	237	12,423	3,657	9,561	11,141
BPS	32,607	42,495	45,802	54,863	65,504
DPS	250	250	350	500	500
Growth (%)					
Sales growth	24.2	(12.3)	8.7	8.7	7.1
OP growth	11.7	(16.3)	12.6	15.0	9.7
NP growth	(97.4)	5,481.0	(70.1)	161.5	16.5
EPS growth	(97.6)	5,141.8	(70.6)	161.5	16.5
EBITDA growth	13.0	(14.0)	11.6	13.8	9.0
Profitability (%)					
OP margin	14.3	13.6	14.1	14.9	15.3
NP margin	0.3	18.1	5.0	12.0	13.0
EBITDA margin	15.3	15.0	15.4	16.1	16.4
ROA	0.1	14.2	4.1	10.0	10.7
ROE	0.7	33.2	8.3	19.0	18.5
Dividend yield	0.3	0.4	0.5	0.6	0.6
Stability					
Net debt (W bn)	309	251	256	220	188
Debt/equity ratio (%)	121.4	71.0	61.3	45.4	33.3
Valuation (X)					
PE	327.8	5.2	21.4	8.2	7.0
PB	2.4	1.5	1.7	1.4	1.2
PS	0.9	0.9	1.1	1.0	0.9
EV/EBITDA	8.8	8.7	9.2	7.7	6.9

Changes to recommendation and price target

Company (Code)	Date	Recommendation	Price target
FILA Korea (081660)	04-19-12	BUY	W98,000
	05-16-12	BUY	W107,000
	07-22-12	BUY	W88,000
	11-15-12	BUY	W76,000
	04-05-13	BUY	W86,000
	11-03-13	BUY	W100,000



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

■ **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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