

Overweight (Maintain)

Company	Rating	TP (won)
• LG H&H (051900)	BUY (-)	422,000(▲)
• AmorePacific (090430)	BUY (-)	1,160,000(▲)
• Able C&C (078520)	-	Not rated
• Kolmar, Korea (024720)	-	Not rated
• Cosmax (044820)	-	Not rated
• Bioland (052260)	-	Not rated
• Daebong LS (078140)	-	Not rated

Contents

I. Sector overview	1
1. Cosmetics boom creates winners in the value chain	
2. Polarization of consumption habits empowers market leaders	
3. Market diversification with China as a fresh growth arena	
II. Major cosmetics companies	5
1. Diversified brands and distribution channels	
2. China, another growth engine beside the solid Korean market	
III. Mid to low-end brand shops arena	10
1. Mid to low-end brand shops rise fast in a polarized market	
2. Second round of competition – brand shops adding premium perception to products and turning overseas	
IV. Cosmetics OEM/ODM sector	13
1. OEM/ODM firms post higher growth than cosmetics market	
2. Separation of production, a step forward to solid growth	
3. Time to focus on China	
V. Cosmetic ingredients industry	21
On a solid growth path	
VI. Company	24

Jung In Lee 3276-6239
jilee@truefriend.com

Jee Hyung Han 3276-6236
jhh6@truefriend.com

Young Joo Huh 3276-6238
youngjoo.huh@truefriend.com

Min Ha Choi 3276-6260
mhchoi@truefriend.com

From raw materials to end-products

Cosmetics boom creates winners in the value chain

The cosmetics market has been in an unprecedented boom since 2008. But the cyclical upturn creates both winners and losers in the value chain. Major cosmetics players, mid to low-end brand shops and OEM/ODM firms have emerged as victors thanks to: 1) the polarization of consumer spending patterns, and 2) a tighter grip on the distribution channels, while small to midsize players have lost ground. Niche market-seeking OEM/ODM providers have fast come to the fore. We maintain Overweight on cosmetics as the boom should continue for the next two years as the polarization of consumption habits drives a structural upturn and market diversification provides new growth engines.

Leaders tighten their grip on a polarized market

The polarization of consumption habits is what defines the future of Korea's cosmetics market. We believe the market will be tilted toward the leaders of each segment in the value chain, which include large players with hegemony in a polarized market, low-budget brands and OEM/ODM players. Major players can flexibly respond to market changes with their diverse selection of brands and distribution channels. Meanwhile, as even the mid to low-end brands are seeking to add a premium perception to their products and as production outsourcing evolves from OEM to ODM, we believe the market will be tilted toward those with strong R&D and financing capacity.

Market diversification with China as a fresh growth arena

The Chinese cosmetics market has an impressive size and attractive growth potential. China's growth momentum does not automatically translate into growth stories for Korean cosmetics players. But we believe Korean cosmetics firms can find a breakthrough in China if they pursue successful positioning strategies with quality products and competitive pricing and make timely responses to the changing market. Among the largest beneficiaries of rising China, AmorePacific has expanded its channels for business expansion. LG Household & Health Care and Able C&C have failed to gain a firm foothold in China's cosmetics market due to weak control over the distribution channels. But they are revamping their strategies, sales networks and brand images for a renewed assault. Cosmax and Kolmar Korea have added production capacity in the expectation that Chinese demand for OEM/ODM will increase thanks to the expansion of the mid to low-end cosmetics market.

Market stars: major cosmetics companies, OEM/ODM firms

Given the positive effects of the cosmetics boom, the level of market control and overseas growth momentum, we prefer major cosmetics companies and OEM/ODM firms in that order. Among large cosmetics companies, our top pick is LG Household & Health Care because its domestic and global diversification can create multiple growth opportunities and its ongoing efforts to forge strategic partnerships with Unilever and the possibility of Coca-Cola Beverage going public could offer upside catalysts. We identify alternative investment opportunities for cosmetics OEM/ODM companies that have a lighter valuation burden than major cosmetics companies. Their investment merits include: 1) the fast segregation of cosmetics production and marketing, 2) a series of new brand launches, and 3) direct benefit from a fast-rising Chinese cosmetics market. Among cosmetics OEM/ODM firms, we pick Kolmar Korea and Cosmax.

I. Sector overview

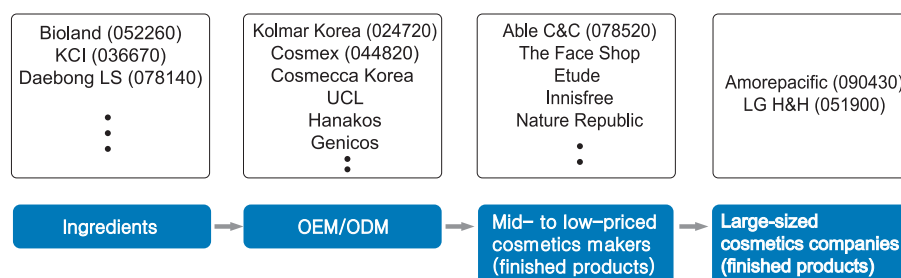
1. Cosmetics boom creates winners in the value chain

In a boom, large cosmetics companies, low-end brands, OEM/ODM firms gain ground, while small to midsize players lose

Cosmetics plays should become more attractive thanks to structural growth and market diversification

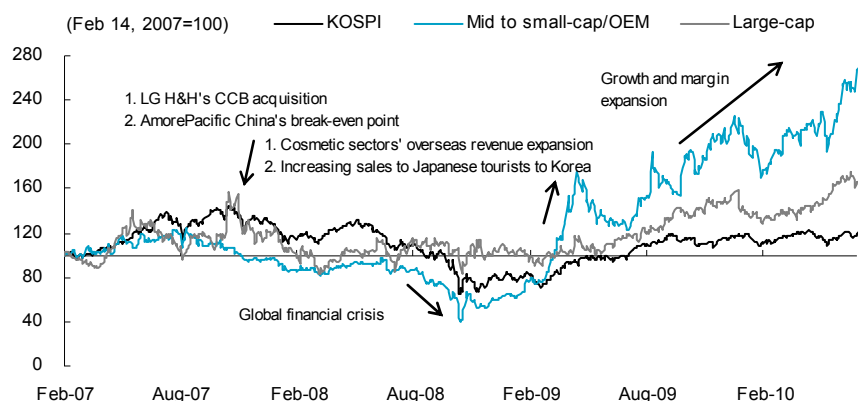
The cosmetics market has been in an unprecedented boom since 2008 thanks to a structural upturn. As result, each component of the value chain from raw material vendors, OEM/ODM firms to end-product makers are benefiting from a virtuous cycle where earnings improvement creates share upside. But the cyclical upturn creates both winners and losers. Major cosmetics players and low-end brands have emerged as victors thanks to: 1) the polarization of consumer spending patterns, and 2) a tighter grip on the distribution channels, while small to midsize players with a focus on mid-priced brands have lost ground. Meanwhile, as low-budget brands and established players have separated sales and production to sharpen cost competitiveness, OEM/ODM firms were new on the scene. The booming downstream businesses should create a stable source of demand for raw material vendors. We believe cosmetics should ride on a cyclical upturn for at least the next two years. Cosmetics plays should become more attractive as: 1) the structural growth continues for the time being thanks to the polarization of consumption habits, and 2) players secure fresh growth engines through market diversification.

Value chain positions by company



Source: Korea Investment & Securities

Cosmetics sector's outperformance relative to Kospi



Note: 1. Large-cap index is the weighted average share prices of LG Household & Health Care and AmorePacific.
2. Mid to small-cap/OEM index is the weighted average share prices of Cosmax, Kolmar Korea, Able C&C, Bioland and Daebong LS.

Source: Quantiwise, Korea Investment & Securities

Polarization of consumption to offer growth momentum for the cosmetics market

Tighter market control by market leaders

-Major cosmetics: diverse distribution channels and brands

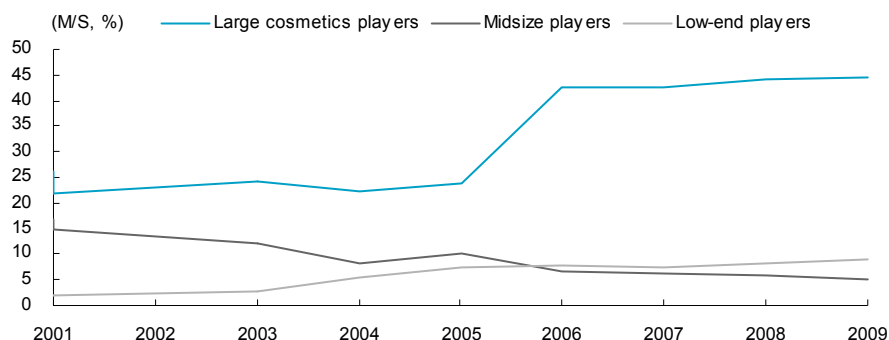
-Low-end brands: premium perception

-Production outsourcing to ODM

2. Polarization of consumption habits empowers market leaders

The polarization of consumption habits is what defines the past and future of the Korean cosmetics market. The emergence of the low-end brand shops during 2003-2004 marked the beginning of the polarization of consumer spending patterns and the trend firmed up since the global financial crisis in 2008. The market landscape has evolved partly due to distribution channel changes where major players have developed a dominant presence. Now the question is whether the polarization of consumption patterns, a driving force behind the cyclical upturn, will be sustainable enough to generate future growth momentum. Our answer is yes. As the polarization of consumer spending should widen the gap between the top and bottom-tier market players, we believe the market will be tilted toward leaders of each segment of the value chain, which include cosmetics companies, low-budget brands and OEM/ODM firms. Major players can flexibly respond to market changes on the back of their diverse selection of brands and distribution channels. Moreover, as even the mid to low-end brands are seeking to add a premium perception to their products and production outsourcing grows beyond OEM toward ODM, the window of growth opportunity should be open to those with strong R&D and marketing capacity. The deepening segmentation between premium brands and low-budget brands catapulted major players and low-priced players into the center of the market. In contrast, established market players with a focus on mid-priced brands lost ground.

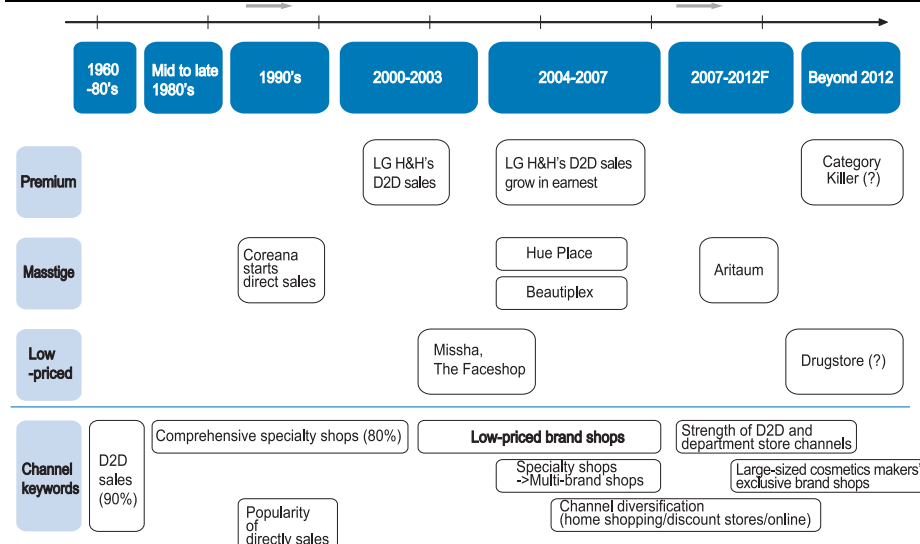
Large players and low-end cosmetics gain ground in a polarized market



Note: Large player (AmorePacific, LG H&H), Midsize (six players including Coreana), low-end (three including Somang Cosmetics)

Source: DART, Korea Investors Service

Distribution channel changes and key developments (1960-present)



Source: Korea Investment & Securities

3. Market diversification with China as a fresh growth arena

China's market size and growth potential merit attention; Korean cosmetics players seek a breakthrough in China

- Aggressive foray:
AmorePacific, Woongjin Coway
- Renewed assault: LG H&H, Able C&C
- Capex: OEM/ODM firms
- Indirect beneficiary:
Bioland

Korean Cosmetics is seeking to grow beyond the domestic walls and turn to China and other overseas markets. We believe the Chinese cosmetics market has an impressive size and attractive growth potential. Positives include: 1) China's preference for imported brands, and 2) the growth potential of both the premium and mass markets there. China's growth momentum does not automatically translate into growth stories for Korean cosmetics players. But we believe Korean cosmetics firms can find a breakthrough in China if they pursue successful positioning strategies with quality products and competitive pricing and make timely responses to the changing Chinese cosmetics market.

AmorePacific and Woongjin Coway have made successful advances on China and are gearing for more aggressive expansion there. LG Household & Health Care (TheFaceShop) and Able C&C (Missha) have failed to gain a firm foothold in China's cosmetics market due to a passive marketing strategy and weak control over the distribution channels. But they are revamping their marketing strategies, sales networks and brand images for a renewed assault. Meanwhile, Cosmax and Kolmar Korea are adding production capacity on expectations that the fast expansion of the mid to low-end cosmetics market will stimulate demand for OEM/ODM service. Raw material vendors such as Bioland should stand to benefit as customers such as major cosmetics companies and OEM/ODM firms extend their reach deeper into China.

Korea's advance on China's cosmetics market

(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	105.25
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 (Ruhon, Cellart, Terreau, etc.)	TheFaceShop	Missha	Etude	n/a	n/a
Distribution channel	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			Capacity addition (no. 2 plant)	
Distribution channel	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

Domestic peer valuation comparison

	Company	Code	Market cap (W bn)	PER (x)			EPS CAGR (%) (09-11F)	PEG (x) 2010F	Sales growth (%)		Operating margin (%)		ROE (%)	
				2009A	2010F	2011F			2010F	2011F	2010F	2011F	2010F	2011F
Large-cap	AmorePacific	090430.KS	5,758	24.8	20.3	17.3	22.8	0.7	12.8	11.0	18.0	18.5	20.8	21.8
	LG H&H	051900.KS	5,474	28.6	22.4	18.8	34.9	0.5	13.8	13.1	13.8	14.7	34.6	33.4
Mid-low end	TheFaceShop	n/a	n/a	n/a	n/a	n/a	34.2	n/a	11.2	14.3	19.1	19.2	45.6	46.2
	Able C&C	078520.KQ	174	7.6	6.5	6.1	23.5	0.2	33.2	20.5	11.7	11.2	34.5	29.6
OEM/ODM	Cosmax	044820.KS	87	8.0	10.8	9.4	7.5	28.1	17.5	14.6	5.2	5.2	16.6	17.3
	Kolmar Korea	078520.KS	187	11.4	11.0	9.3	29.6	0.3	14.3	13.5	8.4	8.8	15.7	16.7
Raw materials	Bioland	052260.KQ	142	8.2	9.4	7.8	28.2	0.3	24.0	20.0	25.8	27.0	21.8	21.8
	Daebong LS	078140.KQ	18	5.6	4.8	4.2	11.5	0.7	11.8	13.0	12.3	12.6	15.8	15.9
Avg				13.5	12.2	10.4	24.0	4.4	17.3	15.0	14.3	14.7	25.7	25.3

Note: Share prices are closing prices on Jul 20,2010
Source: Thomson, Korea Investment & Securities

Global peer valuation comparison

	Company	Code	Market cap (USD mn)	PER (x)			EPS CAGR (%) (09-11F)	PEG (x) 2010F	Sales growth (%)		Operating margin (%)		ROE (%)	
				2009A	2010F	2011F			2010F	2011F	2010F	2011F	2010F	2011F
Japan	Shiseido	4911.JP	5,953	22.9	24.9	20.7	3.5	1.2	4.8	4.6	9.4	9.0	8.6	10.8
	Kao	4452.JP	8,491	27.0	20.8	18.5	13.4	1.7	2.3	2.7	8.7	8.5	9.0	9.8
	Kose	4922.JP	940	22.7	20.4	18.4	7.4	1.8	2.3	2.7	7.2	7.0	5.6	5.5
US	Estee Lauder	EL.US	7,623	44.2	22.8	19.8	30.8	0.2	4.0	5.3	13.2	12.7	29.0	29.3
	Avon	AVP.US	12,257	16.6	14.4	12.6	9.8	7.7	11.2	14.7	19.1	19.2	45.6	46.2
	P&G	PG.US	178,151	14.5	15.0	15.5	(2.2)	(4.5)	2.7	4.7	22.1	21.5	18.5	18.5
France	L'Oreal	OR.FP	49,214	24.0	20.9	18.8	8.4	1.4	6.2	6.1	16.9	15.9	16.0	15.9
	Christian Dior	CDI.FP	20,999	20.2	15.4	13.4	14.6	0.5	7.3	7.6	22.0	20.5	13.9	14.6
Avg				24.2	18.5	16.7	11.7	1.3	5.1	6.3	15.6	15.1	19.7	20.0

Note: 1. Share prices are closing prices on Jul 20,2010
2. Global players' earnings are Thomson estimates.
Source: Thomson, Korea Investment & Securities

II. Major cosmetics companies

1. Diversified brands and distribution channels

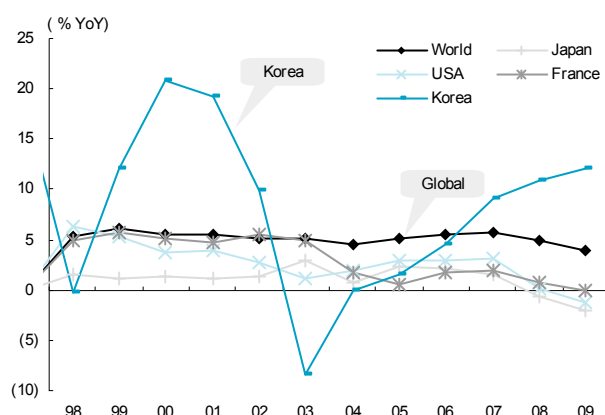
Major cosmetic companies are tightening their grip on the market at a faster pace than before thanks to: 1) the polarization of consumption habits, 2) flagship brands that can match foreign brands, and 3) strong control over distribution channels. The distribution system is centered on department stores, door-to-door sales networks and brand shops at present but should evolve down the road. Even if the distribution paradigm changes, we believe major cosmetics brands should maintain their market lead because they should make a timely response to changing consumption patterns and distribution paradigm thanks to: 1) an extensive portfolio and distribution channels encompassing premium to low-budget brands, and 2) their experience and know-how.

1) Consumers trading up to premium products

Premium brand and channel expansion

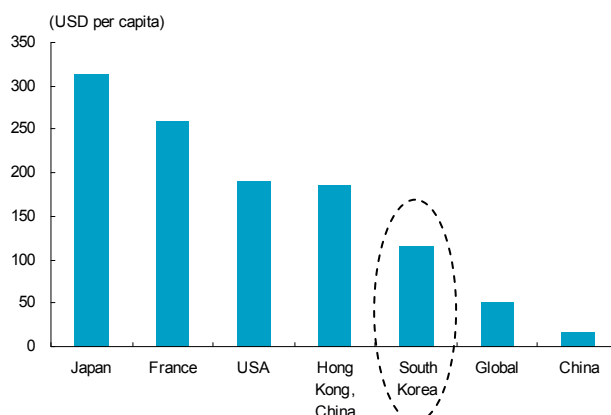
The gradual emergence of the mass-market channel does not ring the death knell for the premium channels. In Korea's cosmetics market, premium channels continue to play an important role given the contribution to sales and growth potential. Higher income levels and the deepening polarization of consumption habits should bolster the demand for premium products and major cosmetics players should prod consumers to trade up to more premium products over the next couple years. We believe market conditions are ripe for major cosmetics players to demonstrate strong growth potential in the premium channels as: 1) Korea's per-capita spending on cosmetics is still low compared to advanced countries, 2) high-priced functional cosmetics are making a greater sales contribution, 3) department stores and door-to-door sales should post respective solid growth of 22.2% YoY and 8.0% YoY in 2010F.

Korea's cosmetics market growth is above the global average



Source: Euromonitor, company data, Korea Investment & Securities

Korea's per-capita spending on cosmetics is less than advanced countries



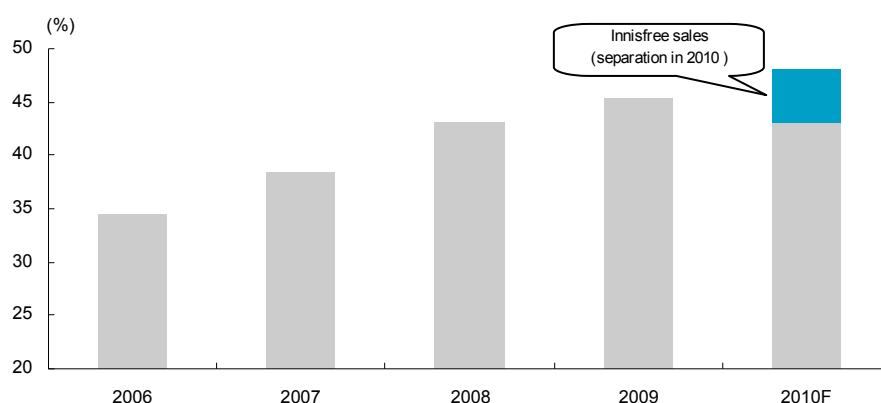
Source: Euromonitor, company data, Korea Investment & Securities

Leaders to dominate the mass-market channel and gain market share

2) Tighter grip on mass-market channel

AmorePacific and LG Household & Health Care are expanding their own specialty store networks Aritaum (dedicated outlet for AmorePacific products) and Beautiplex (multi-brand shop), which helps tighten their grip on the mass-market channel and leaves few options for other established players. As such, leaders are gaining share in the mass-market channels. We believe leading players should make more aggressive entry to the specialty cosmetics stores channel to expand their top line and gain share.

Leading players to gain share in the specialty stores channel



Source: Euromonitor, company data, Korea Investment & Securities

Low-end brands affiliated with big-name companies should stand out from the rest

3) Budget cosmetics reshaped toward big-name companies

AmorePacific's decision to separate its low-end brands Etude and Innisfree, and LG Household & Health Care's acquisition of TheFaceShop signals the budget cosmetics market is being reshaped toward big-name companies. The low-budget cosmetics market is fragmented with more than 10 brands and an increasing number of entrants. Nevertheless, we believe low-end brands affiliated with big-name companies should stand out from the rest due to: 1) R&D and production capacity to launch premium lines, 2) bargaining power against OEM/ODM firms as they can rely on their parent companies' production facilities, and 3) synergy effects by introducing cross-company mileage programs.

2. China, another growth engine beside the solid Korean market

1) AmorePacific to make an aggressive foray in China

AmorePacific's Chinese subsidiary delivered a 2006-2009 sales CAGR of 25.7%

Among domestic-demand driven plays, AmorePacific is considered the largest beneficiary of rising China. Its Chinese subsidiary delivered 2007-2009 sales CAGR of 25.7% with the release of Laneige (premium line) in 2002 and Mamonde (mass-market line) in 2005. In competition against Japanese, US and European rivals that together commanded 59.1% of the Chinese cosmetics market (2009 Euromonitor), Laneige ranked ninth in brand recognition (2008 Euromonitor) and has well-positioned itself in the premium market.

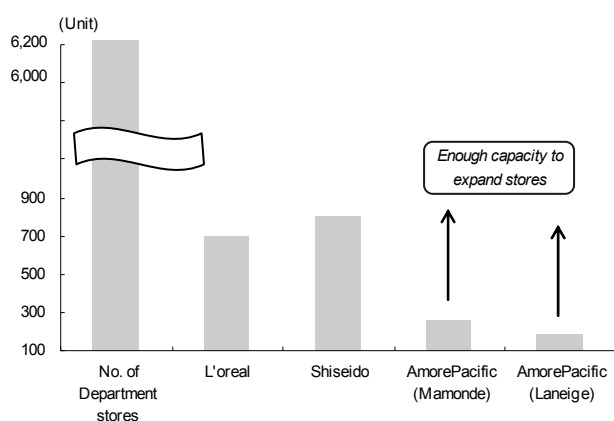
Channel expansion and specialized marketing strategy should drive sales in China; China to make up 20% of AmorePacific's sales in 2015

AmorePacific's successful entry to China has been raved about over the past couple years since its Chinese subsidiary passed the breakeven point in 2007. Now, investors are more interested in whether the company can: 1) drive faster top-line growth, and 2) secure additional growth momentum. The Chinese subsidiary's earnings contribution represented 5.7% of AmorePacific's total sales and 5.4% of EBT in 2009. Accordingly, the company's top line should significantly expand so that its success in China can bolster the enterprise value rather than be a temporary boost for investor sentiment. AmorePacific plans to increase China's sales portion to 20% by 2015 through: 1) aggressive channel expansion (addition of average 80 department store counters each year until 2015), and 2) marketing and ad campaigns tailored to meet brand needs. We believe the expansion strategy is feasible as: 1) the number of Chinese department stores reaches 6,000, and 2) Chinese market leaders such as P&G and L'Oreal had about 700 counters in department stores as of 2009 versus Laneige's 172 and Mamonde's 251. The Chinese subsidiary's store additions alone should drive its sales to see a CAGR of 38.4% during 2009-2015F.

Additional growth momentum from new brand launches and advance on door-to-door sales

Further growth momentum, absent from our sales estimates, include: 1) additional brand launches, and 2) advance on door-to-door sales. As part of the company's efforts to enhance the brand lineup in China, three or four brands including Sulwhasoo (2H10) and Etude (2011) should debut by 2015. The launch of Sulwhasoo should help enhance its luxury premium brand image. On the other hand, market incumbent Mamonde or other prospective entrants such as Etude could bolster sales growth and market expansion thanks to a focus on the mass and masstige segments which together represent 80% of the overall cosmetics market.

No. of counters in China's department stores by major peers



AmorePacific's Chinese subsidiary's growing sales contribution



Note: Mamonde, Laneige (1st quarter in 2010)

Source: Company data, Korea Investment & Securities

Source: AmorePacific, Korea Investment & Securities

2) LG Household & Health Care to make renewed foray in China

Pros: LG H&H's aggressive overseas expansion and acquisition of mass-market brand TheFaceShop

Waking up from its passivity, LG Household & Health Care plans to make an aggressive advance on the overseas markets from 2011 when the three-year restructuring is complete. LG Household & Health Care's growth engine is the domestic market, which accounts for 93% of total sales. Even if the company widens its Chinese presence, its top-line impact should be marginal over the short-term. Nevertheless, the overseas expansion should help diversify growth engines on the long-term horizon, which we believe is positive. Such strategic changes are possible as the company has domestically succeeded in securing growth potential and profitability and now can afford to look outside. With the acquisition of TheFaceShop, the company has secured a brand or good access to the mid to low-end mass market that has strong growth potential.

Top-line growth in China will depend on whether or not the cosmetics segment can turn around

The primary target market is China which accounts for 70% of LG Household & Health Care's exports or W93.4bn in 2009. Cosmetics represent 50% of LG Household & Health Care's exports to China and household products take the rest. After the successful launch of bamboo salt toothpaste in 2001, the company has delivered fast CAGR of 27.1% by enhancing its premium brand image and diversifying its product offerings in the bamboo salt toothpaste category. As household products should fast expand with a CAGR of 15%, we believe the top-line growth in China will depend on whether or not the cosmetics segment can turn around.

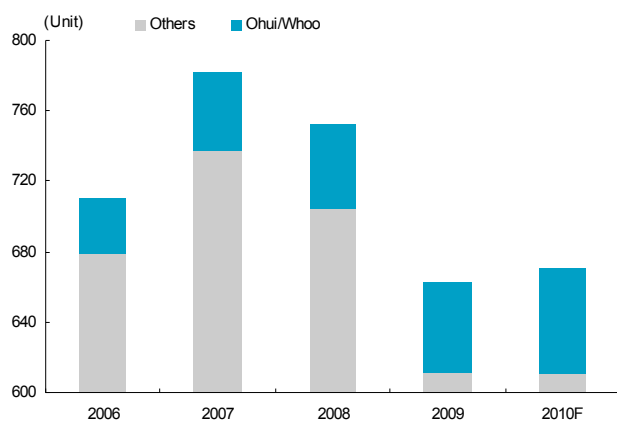
LG Household & Health Care made an earlier entry to China than AmorePacific by establishing a subsidiary there in 1994 but its cosmetics business has stagnated due to the absence of: 1) competitive brands to challenge foreign rivals who together command 59.1% of China's market, 2) a well-designed positioning strategy and efficient distribution channels, and 3) tight control over pricing and channel inventory due to its reliance on wholesalers.

Cosmetics top line has stagnated due to a three-year restructuring drive

In China, LG Household & Health Care has taken drastic measures over the past three years to consolidate less-profitable brands such as DeBon and Trea, which are discontinued brands in Korea, and reduce the number of low-end brand shops. As a result, despite the fast-growing premium brands such as Ohui and Whoo, the Chinese top line has stagnated and the operating loss swelled to W6.5bn in 2009. Nevertheless, we believe the company has made a wise move to improve its profitability and should turn around from 2011.

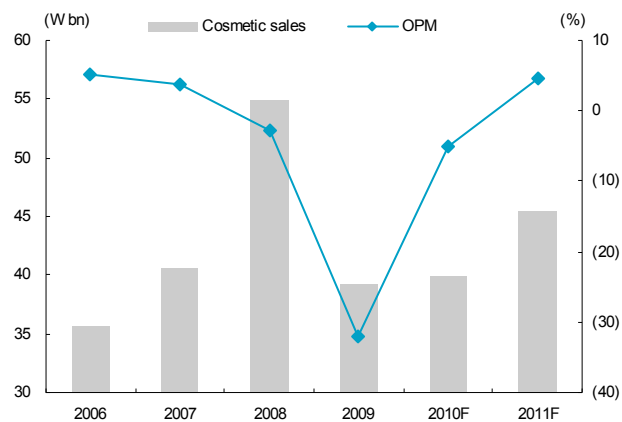
2011 earnings turnaround: greater focus on premium line, TheFaceShop store additions, brand consolidation

The company should seek to expand its presence in the Chinese cosmetics market by: 1) strengthening its direct marketing of premium brands (Ohui and Whoo), 2) expanding TheFaceShop's master franchise channels from two to 10, and 3) revamping its brand lineup to place a greater focus on Whoo (luxury), Ohui (premium) and SooRyeHan (masstige).

**Restructuring of non-core brands and channels
(2007-present)**


Note: Others (six players including Isaknox)

Source: LG H&H, Korea Investment & Securities

China's cosmetics business turnaround


Source: Euromonitor, company data, Korea Investment & Securities

III. Mid to low-end brand shops arena

1. Mid to low-end brand shops rise fast in a polarized market

Brand shops rise fast thanks to more polarizing consumption habits

The mid to low-end brand shops market took off in 2002 when Able C&C started selling cosmetics for ₩3,300 under the brand name Missha. Able C&C's super-low pricing satisfied a growing number of customers seeking price benefits in a post-crisis market and coincided with the lipstick effect – a tendency of consumers to purchase small items like lipstick that can offer emotional comfort for a relatively low price during economic slumps. Able C&C recorded ₩100bn in sales in just three years after its debut and the mid to low-end cosmetics market has fast expanded with an increase in copycat brands. Mid to low-end brand shops are focused on marketing and sales while outsourcing all production. Those with production facilities increasingly outsourced their non-core activities, which drives up the number of OEM/ODM firms.

Brand shops made a big rebound on the economic slump in 2008 and brand makeover

Mid to low-end brand shops once struggled with the swelling number of rivals and resulting profitability erosion but made a strong comeback as the gap in consumer spending patterns widened in the wake of the global financial crisis in 2008. Mid to low-end cosmetics sales rebounded as large corporations' focus on the high-margin premium segments created a niche market and the number of price-aware consumers increased due to the economic slump. Departing from mutually destructive competition in the mid 2000s, market players have developed their own brand concepts such as functional cosmetics (blemish balms), "gimmick" food cosmetics and natural cosmetics (Natural Story), and diversified their sales channels to subway station shops, marts and vendor-in-shop formats. Moreover, with the explosive popularity of Korean culture, mid to low-end brand shops appealed to Asian consumers such as the Japanese and Chinese and easy sales to Asian tourists visiting Korea also drove up the top line. As major cosmetics companies dominate the premium market on the back of strong financing and aggressive marketing, and mid to low-end brand shops had a strong appeal with quality and price-conscious consumers, Coreana, Hankook Cosmetics and Nadri Cosmetics – the big three names in the early 2000s – went downhill and polarization of the cosmetics market has intensified ever since.

Major brand shops and sales

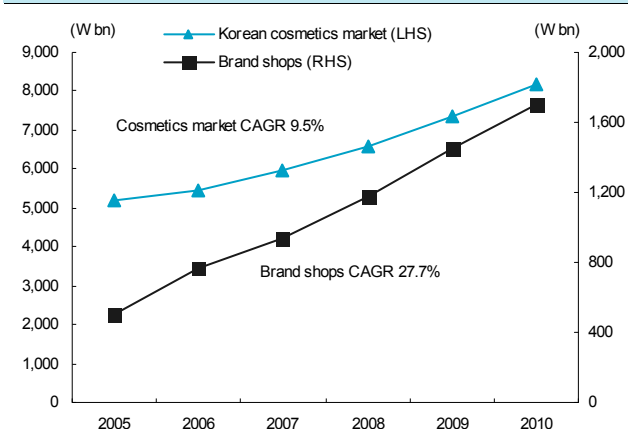
(Units, ₩ bn,)

	Brand shop	Company	Stores (1H10)	Sales (2009)	Sales per store (2009)
Masstige	Aritaum	AmorePacific	1,150	260	0.2
	Beauti plex	LG H&H	1,009	100	0.1
	TheFaceShop	LG H&H	737	257	0.4
	Missha	Able C&C	410	181	0.5
	Skin Food	Skin Food	410	115	0.3
Mid-low end	Innisfree	Pacific Co.	280	55	0.2
	Etude House	Pacific Co.	210	115	0.5
	Tonymoly	Taesung Group	160	40	0.3
	Nature Republic	Nature Republic	99	22	0.3

Source: Industry data

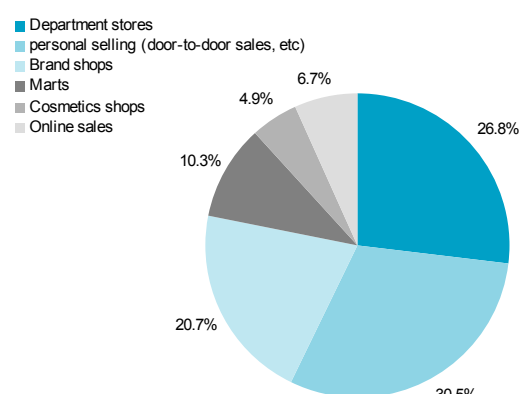
Brand shops are classified into multi-brand (Aritaum, Beauti plex) and dedicated outlets (TheFaceShop, Missha, Skin Food). According to industry sources, the number of dedicated outlets is almost the same as multi-brand stores but the former's sales double the latter. Multi-brand stores are evolving into total beauty shops that offer a wide array of services from skin type analysis and counseling, while dedicated outlets are making all-out efforts to communicate a distinctive brand personality and add premium value on top of price merits. There is heated competition among the players to extend their store networks. AmorePacific has 1,150 Aritaum stores, while LG Household & Health Care has 1,009 Beautiplex. TheFaceShop has 737 stores, the most among the dedicated outlet players, while Missha and Skin Food have 410 stores each.

Growth trend: Cosmetics market and brand shops



Source: AmorePacific, Korea Investment & Securities

Cosmetics distribution channel breakdown in 2009



Source: AmorePacific, Korea Investment & Securities

Brand shop sales to reach W1.7trn in 2010

According to AmorePacific, dedicated shop sales should climb 17.2% YoY to W1.7trn in 2010 or 21% of the domestic cosmetics market as low-end shops aggressively open locations. Mart sales should be up 10.7% YoY to W847bn during the same period thanks to the expansion of complex shopping centers (CSC) and the emergence of corporate supermarkets, while online sales (Internet and home shopping) increase 8.9% YoY to W550bn.

2. Second round of competition – brand shops adding premium perception to products and turning overseas

Brand stores place a greater focus on profitability per store rather than growth in size

Recently, brand shops are charting a growth path that differs from the mid-2000s. As price merit offers limited growth momentum, brand shops are branching out to masstige cosmetics (an amalgam of mass market and prestige) and allow store additions only in good locations with proven traffic. That is, brand stores place a greater focus on profitability per store rather than growth in scale. Able C&C's Missha added high-end products to its product portfolio in 2009 and the prestige product sales bolstered the bottom line and attracted middle-class consumers. The average selling price of Missha has ballooned to W10,000 or more compared to W4,000 in its early years. Frequent promotional events are helping weaken consumer resistance to the price rises. Meanwhile, capitalizing on LG Household & Health Care's R&D capacity, TheFaceShop is shoring up its premium lines, which should raise the ASP from W15,000 to W30,000 over the mid to long-term.

Market leaders go after China

The recent developments mark a significant departure from the past because brand shops are seeking new breakthrough in mart channels and overseas arenas such as China and the Middle East. Leading dedicated shops such as TheFaceShop, Missha and Skin Food are already in Taiwan, Singapore, Indonesia, Japan and China and staging strategic campaigns to extend their overseas presence. In particular, we believe China is the most coveted market for leading players. Given that low-end branded outlets have a marginal presence in China, which has significant size and growth potential, it can create a new niche market for Korean cosmetics companies. Able C&C leads the foray in China in terms of the number of shops and top line but its business is still at the early stage. As the company plans to strengthen its direct sales operation in China, its future is more promising now than it has been. TheFaceShop is set to establish a Chinese subsidiary in 2H10 and expand its master franchise partnerships, while Etude House aims at brand launches in China in 2011.

TheFaceShop in Beijing



Source: TheFaceShop, Korea Investment & Securities

Missha in the Middle East



Source: Able C&C, Korea Investment & Securities

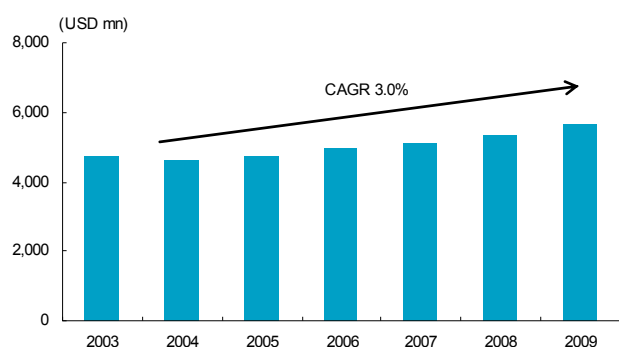
IV. Cosmetics OEM/ODM sector

1. OEM/ODM firms post higher growth than cosmetics market

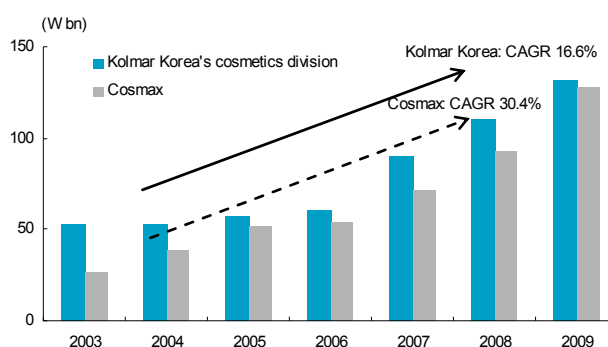
**Leading cosmetics
OEM/ODM firms: Kolmar
Korea and Cosmax**

Despite the absence of hard figures on Korea's cosmetics OEM/ODM firms, we estimate there are 300 players based on our company visits and interviews. Among cosmetics OEM/ODM companies, only two – Kolmar Korea (W131bn) and Cosmax (W127.7bn) – breached W100bn sales in 2009 while seven to 10 established players such as Cosmecca Korea and UCL posted annual sales of W10bn-40bn. OEM/ODM leaders Kolmar Korea and Cosmax saw their sales grow much faster than the domestic cosmetics market over the past five years. We attribute the sharp increase in cosmetics OEM/ODM demand to the following. 1) Dedicated brand shops have emerged at the center of the cosmetics distribution channels. 2) Most of the small to midsize cosmetics companies have outsourced 100% of their production to OEM/ODM firms. 3) Leading cosmetics OEM/ODM players have tightened their market grip with superb production capacity and competitive products.

Korea's cosmetics market growth (2003-2009)



Kolmar Korea and Cosmax annual sales (2003-2009)



Note: 1. Retail value RSP, fixed 2009 FX rates - value at current prices.

Source: Kolmar Korea, Cosmax, Korea Investment & Securities

2. Cosmetics market= cosmetics + toiletries
Source: Euromonitor, Korea Investment & Securities

Emergence of brand shops

As direct selling has weakened since the credit card crisis in 2003, brand outlets such as Missha and TheFaceShop have taken center stage of the cosmetics distribution channel. The emergence of brand shops has significantly changed the mid to low-end market landscape. The life cycle of the product trend is getting shorter and consumers are becoming more price-sensitive, while a series of products make seasonal hits. Such developments allowed cosmetics OEM/ODM firms to expand production and R&D capacity.

Major brand shops (2002-2009)

Market debut	Brand shop	Brand concept
Apr. 2002	Missha	Prestige brand shop
Dec. 2003	TheFaceShop	Natural and part of daily life
Sep. 2004	Beautiplex	Beauty island
Nov. 2004	Beautycrédit	Beauty and trust
Dec. 2004	Skin Food	Food based cosmetics
Aug. 2005	Etude House	Sweet dreams of youth, beauty
Oct. 2005	Banila co	Stylish & trendy cosmetics
Dec. 2005	Innisfree	Green lifestyle in harmony with nature
Jun. 2006	It's skin	Clinical skin solutions based on doctor's advice
Jan. 2007	Tonymoly	Urban, stylish, modern
Aug. 2007	Ontree	Natural & organic multi-cosmetic shops
Aug. 2008	Yvesrocher	Total beauty service brand shops
Aug. 2008	Aritaum	Tailored solution
Mar. 2009	Nature Republic	Pristine vitality

Source: Cosmax, Korea Investment & Securities

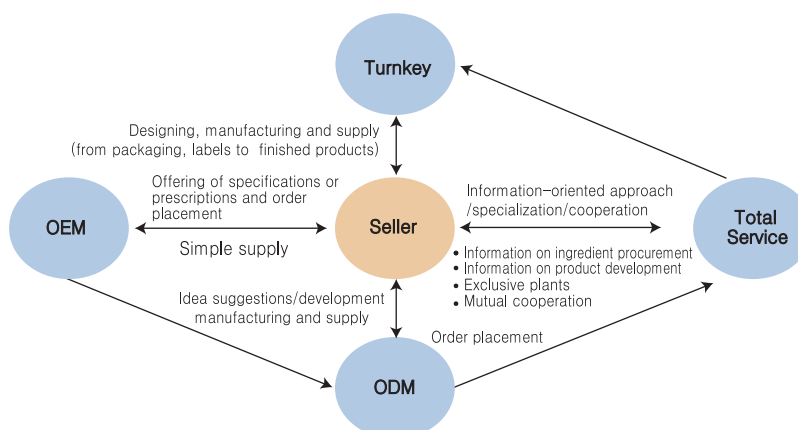
Separation of production and marketing accelerates in the mid to low-end cosmetics segment

Kolmar Korea and Cosmax have one thing in common in that they took over cosmetics-making facilities from cosmetics companies to expand their capacity. Kolmar Korea acquired plants from Mix&Match (Natural Story) and VOV in 2006, while Cosmax purchased a plant from Somang Cosmetics. Aside from plant acquisitions, they have forged strategic partnerships to maximize their synergy effects. Kolmar Korea and Cosmax not only take production orders from companies who sold the production facilities but also enhanced cooperation with them through joint R&D projects. As a result, Korea's cosmetics market has fast shifted toward the separation of production and pre/post-production operations. This allows cosmetics companies to concentrate their resources on marketing, brand imaging, R&D, distribution and sales but outsource their production to OEM/ODM firms. In particular, as production outsourcing creates significant cost savings in the mass-market segment, the cosmetics OEM/ODM trend should fast catch on among general cosmetics companies' mid to low-end lines and small to midsize companies.

Greater competitiveness thanks to a shift from OEM to ODM

The driving forces behind the fast growth of the cosmetics OEM/ODM market include changing distribution channels, economies of scale and greater partnerships. But the point not lost on investors is that cosmetics OEM/ODM companies have lived up to the market's expectations with their strenuous R&D efforts to bring product quality and price competitiveness to a higher level. Looking at the business portfolio of Kolmar Korea and Cosmax, we believe the portion of ODM-based production is above 90%. That is, Kolmar Korea and Cosmax have grown beyond OEM contractors to provide one-stop service that encompasses raw materials procurement to end-product supply. These companies are taking a step further toward a turnkey production system, up to designing product containers and labels. From their cosmetics ODM business, turkey-basis accounts for 60% at Kolmar Korea and 45% at Cosmax.

Cosmetics OEM/ODM developments



Source: Korea Investment & Securities

Major OEM/ODM players to benefit from the growing functional cosmetics market

To reflect the growing importance of a new segment, the cosmetics market has added one more category, functional cosmetics, to its usual product classifications – basic skin care, hair care and color makeup. Korea's cosmetics market in 2008 was dominated by basic skin care (45%) followed by functional cosmetics (23%), hair care (15%) and color makeup (7%). We believe the fast growth of functional cosmetics merits attention. Functional cosmetics, which include anti-wrinkle, skin whitening and UV protection, recorded W1.03trn in production value in 2008 and led the domestic cosmetics market with a five-year CAGR of 24%.

The fast growth is attributable to competitive technologies and price competitiveness which enables the fast spread of functional cosmetics beyond the prestige line to the mass-market line.

Cosmetics production by category (2004-2008)

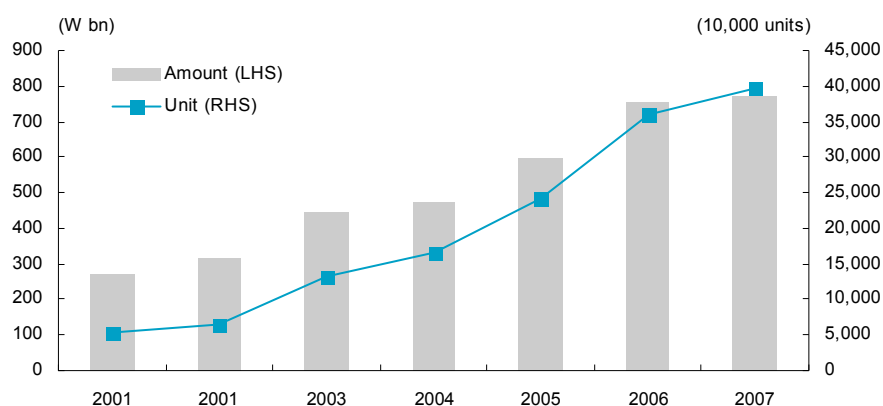
(W bn, %)

	2004		2005		2006		2007		2008	
	Production volumes	%	Production volume	%	Production volume	%	Production volume	%	Production volume	%
Basic skin care	1,585	46.1	1,704	46.2	1,791	45.0	1,869	45.9	2,109	44.7
Functional cosmetics	473	13.8	597	16.2	753	18.9	773	19.0	1,103	23.4
Hair care	553	16.1	616	16.7	627	15.8	593	14.5	685	14.5
Color makeup	357	10.4	340	9.2	317	8.0	332	8.2	308	6.5
Bath products	72	2.1	89	2.4	101	2.5	117	2.9	159	3.4
Eye makeup	113	3.3	101	2.7	113	2.8	109	2.7	119	2.5
Shaving products	154	4.5	128	3.5	144	3.6	166	4.1	97	2.1
Children products	64	1.9	49	1.3	76	1.9	55	1.3	79	1.7
Air fresheners	32	0.9	34	0.9	30	0.8	30	0.7	25	0.5
Nail care products	22	0.6	22	0.6	18	0.5	17	0.4	24	0.5
Hair coloring products	10	0.3	12	0.3	10	0.3	12	0.3	11	0.2
Total	3,437	100	3,693	100	3,980	100	4,074	100	4,720	100

Source: Korea Cosmetic Association

As functional cosmetics extend their market reach to the mass-product line, it creates a big opportunity for major cosmetics OEM/ODM firms as the items sell for higher ASPs and generate bigger margins than other products. Heated competition in the mid to low-end market makes it imperative to develop highly functional, high-efficiency cosmetics, and this leads to greater earnings. In the process, the cosmetics OEM/ODM landscape has changed. Looking at the cosmetics OEM/ODM market, major players such as Kolmar Korea and Cosmax are focused on basic skin care and functional cosmetics while small to midsize players are engaged in the low-priced, fragmented color cosmetics market.

Functional cosmetics production (2005-2007)



Source: Korea Cosmetic Association, Korea Investment & Securities

2. Separation of production, a step forward to solid growth

Separation of production a step forward to solid growth

The Korean cosmetics OEM/ODM market should enjoy steady growth although the pace will not be as fast as in the past. Mass-market cosmetics have already separated production from marketing, and prestige products are unlikely to create new markets for cosmetics OEM/ODM. General cosmetics players such as AmorePacific and LG Household & Health Care have established their own R&D and production facilities for their prestige lines and are reluctant to outsource production to safeguard their brand images. We believe mandatory labeling of cosmetic product makers will be a negative. Cosmetics for infants and men are unlikely to offer fresh or strong growth momentum. But we do not believe the mass-market can depart from the separation of production and pre/post production stages. As large cosmetics OEM/ODM companies have achieved economies of scale, it is unreasonable for them to go back to in-house production. All in all, Korea's cosmetics OEM/ODM market should closely follow the mid to low-end cosmetics segment in its growth path.

Direct exports on a moderate upward path

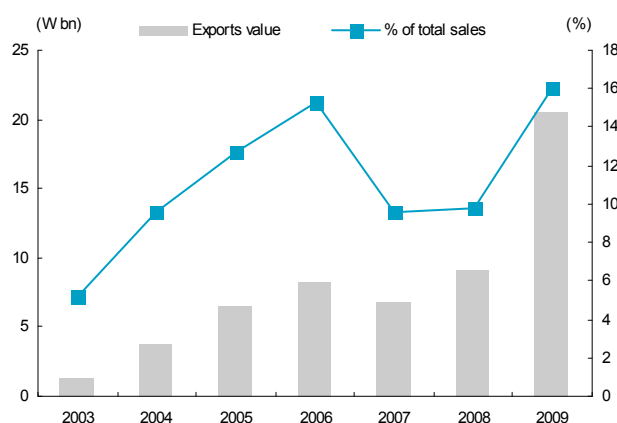
Given Korea's production capacity and market conditions, we do not believe cosmetics exports have explosive growth potential. Among total cosmetics sales, exports accounted for 11% at Kolmar Korea and 16% at Cosmax in 2009. When excluding intercompany transactions with Cosmax Shanghai in the form of raw materials and semi-finished products, Cosmax's exports portion would drop to the 13% level. In contrast, Kolmar Korea's exports portion would increase thanks to Kolmar Beijing's production startup in April 2010. Korea's direct cosmetics exports are increasing to Japan and other Asian countries. But given that demand for cosmetics OEM/ODM has been locally digested to a significant extent, Korea's exports growth areas should be limited to products that require a high level of technology or competitive prices that cannot be matched by local OEM/ODM players. As Kolmar Korea and Cosmax have domestically expanded their order books, their exports portion should remain below the 15% level.

Kolmar Korea's exports and % of sales (2003-2009)



Source: Kolmar Korea, Korea Investment & Securities

Cosmax's exports and % of sales (2003-2009)



Source: Cosmax, Korea Investment & Securities

Additional growth momentum

1) New entrants

The emergence of new competition from firms such as Woongjin Coway should provide a catalyst to growth momentum because entrants are more likely to follow the current market shift toward product separation rather than undertake massive facility investments. A series of brand shop startups such as Hanskin House (Hanskin, Dec 2009), Tears (actor Kwon Sang-woo, Dec 2009) and Holika Holik (Enprani, Mar 2010) are positive as well. Although the number of mid to low-end brand shops already exceeds 4,500 (dedicated outlets: 2,200, multi-brand shops: 2,300), new openings continue because market players want to: 1) benefit from the lipstick effect in which low-priced products such as lipstick sell well amid an economic slump, 2) attract consumer attention to new brand concepts as mid to low-end shoppers make impulse buying decisions rather than focus on brand loyalty, and 3) expect steady mid to low-end demand in a polarized cosmetics market.

2) A series of best-sellers

Growth momentum should be driven by a constant stream of seasonal best-sellers such as blemish balms, hand sanitizers and body slimming products. Opening a new chapter in best-selling cosmetics, blemish balms created a market worth W100bn in 2007 and have continued to enjoy steady demand ever since. Demand for hand sanitizers doubled in 2009 as the outbreak of H1N1 renewed the desire for personal hygiene. The body slimming products market, which enjoys peak-demand during summer, should fast expand in 2010. As such markets, which were almost nonexistent or marginal, have gone mainstream, cosmetics OEM/ODM firms should benefit from the developments down the road.

Missha BB cream and Nadri's hand sanitizer



Source: Media reports, Korea Investment & Securities

Etude's slimming products



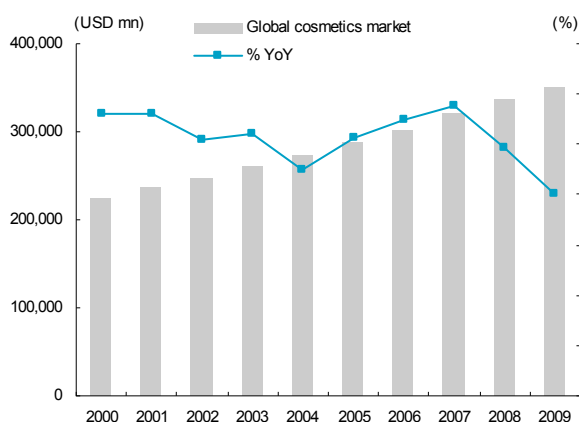
Source: Media reports, Korea Investment & Securities

3. Time to focus on China

Major OEM/ODM manufacturers to advance to China

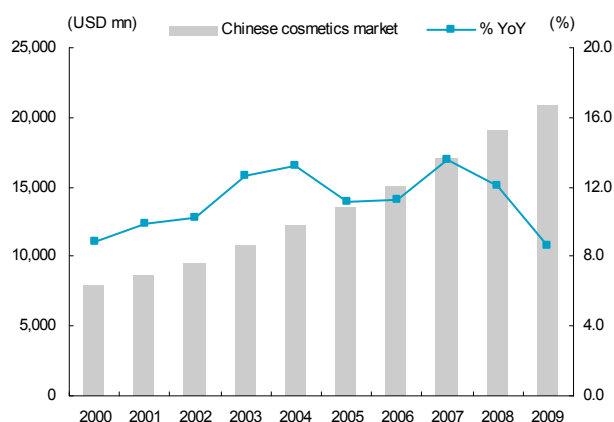
Korea's leading cosmetics OEM/ODM firms are making aggressive localization efforts in China. Cosmax's Chinese subsidiary, Cosmax Shanghai, has been around since 2004 and Kolmar Korea's Kolmar Beijing started production in April 2010. Following the US and Japan, China has emerged as the world's third-largest cosmetics market and should provide fresh growth momentum for Korean players who face growth hurdles domestically. The center of China's cosmetics market is shifting from the mid to low-end segment to the premium line and Korean cosmetics have secured a firm footing there. We believe major Korean OEM/ODM players will be affected, both directly and indirectly, by Korean cosmetics companies doing business in China.

Global cosmetics & toiletries market (2000-2009)



Note: Retail value RSP, fixed 2009 FX rates - value at current prices.
Source: Euromonitor, Korea Investment & Securities

Chinese cosmetics & toiletries market (2000-2009)



Note: Retail value RSP, fixed 2009 FX rates - value at current prices.
Source: Euromonitor, Korea Investment & Securities

Center of China's cosmetics market shifting from the premium line to mid/low-end

China's cosmetics market has delivered a CAGR of 11% or more as the ranks of the middle class have swelled in a fast-growing economy. Mid to low-end cosmetics, a driver of the overall market expansion, posted the fastest growth in top-tier cities such as Beijing and Shanghai. But we expect the next growth market to be second-tier cities. An analysis of the distribution channel changes over the past 10 years shows the portion of prestige products (direct-sale and department store counters) has declined from 58% to 44% but mass-market products (supermarkets, hypermarkets, drug stores and convenience stores) jumped from 31% to 47%. Considering the cosmetics OEM/ODM format is more popular in the mass-market line than the prestige line, we believe the recent developments will be favorable to cosmetics OEM/ODM firms. Over the long-term, the expansion of the mid to low-end market should give birth to the separation of production and marketing in China as well. If such is the case, the largest beneficiaries could be Korean players who are technologically at least five years ahead of their Chinese rivals. Cosmax Shanghai, which entered China faster than Kolmar Korea, recorded a whopping sales growth from W1.7bn in 2006 to W14.7bn in 2009. As an aside, it is meaningful that Cosmax Shanghai's growth was achieved without the help of other Korean companies doing business in China. Korean companies accounted for 20% of Cosmax Shanghai's sales in 2009.

Chinese cosmetics market and distribution channels (2000-2009)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Supermarkets/Hypermarkets	24.7	26.5	28.3	30.1	30.4	32.9	34.2	34.5	34.6	34.5
Department stores	47.6	39.7	35.2	31.5	29.6	29.5	30.5	30.6	30.9	31.1
Direct sales	10.4	13.9	15.8	17.8	18.9	16.0	13.6	13.2	13.1	13.1
Pseudo-pharm/Drugstores	2.6	3.1	3.7	4.1	4.6	5.6	6.1	6.6	6.6	6.6
Convenience stores	3.2	6.3	7.6	7.6	7.9	7.1	6.6	6.3	6.1	6.0
Beauty specialty retailers	2.5	3.0	3.4	3.9	4.1	4.5	4.7	4.7	4.6	4.6
Chemists/pharmacies	0.2	0.4	0.7	0.8	1.0	1.2	1.3	1.4	1.4	1.5
Independent small grocers	7.0	5.3	3.8	2.7	1.7	1.3	1.1	1.0	1.0	0.9
Internet retail	0.0	0.2	0.3	0.4	0.6	0.7	0.8	0.8	0.8	0.9
Home shopping	1.7	1.4	1.2	1.1	1.1	1.2	1.0	0.9	0.8	0.8
Other non-grocery retail	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: AmorePacific, Korea Investment & Securities

OEM/ODM demand from Korean cosmetics companies in China should be insignificant

China-based Korean OEM/ODM players should benefit from Korean cosmetics companies there in two ways – greater demand from both Korean and Chinese cosmetics companies. First, China-based Korean OEM/ODM firms would receive production orders from their Korean counterparts. Second, they stand a better chance of developing business relations with Chinese customers as successful Korean cosmetics companies help put a good face on Korean OEM/ODM firms. But Korean cosmetics companies such as AmorePacific and LG Household & Health Care have already established their own production bases in China. As they make mass-market products in-house and import prestige products from Korea, their demand for OEM/ODM services is not very much, which explains why Korean cosmetics companies account for only 20% of Cosmax Shanghai's sales. Based on our company visits and interviews, we predict Korean general cosmetics companies doing business in China are unlikely to shift to the OEM/ODM format in the near-term. Kolmar Beijing, which is new to China, and Cosmax Shanghai, which has six years' experience, have made it clear they place a greater focus on Chinese cosmetics companies rather than Korean outfits.

As Korean cosmetics companies gain ground in China, it will favor Korean OEM/ODM firms

As Korean cosmetics companies gain ground in China, it should favor China-based Korean OEM/ODM companies. Thanks to the explosive popularity of Korean pop culture in Asia, Chinese customers are more drawn to Korean cosmetics and Chinese cosmetics companies have made a role model out of their Korean rivals in their transition from the low-end to mid/high-end markets. As such, there is a growing importance of developing partnerships between Chinese and Korean cosmetics companies and the technologies Korean OEM/ODM firms own should be in demand for Chinese cosmetics companies to develop and make new products. We believe Korean OEM/ODM companies are in a more advantageous position than their Japanese and European rivals. Europe considers China as nothing but a global production base, while Japan is focused on its own brand production and lacks price competitiveness. As such, we believe Korean OEM/ODM providers can become ideal partners for Chinese cosmetics companies.

Cosmax Shanghai and Kolmar Beijing: earnings estimates and 2010F target

(W bn, 10,000 units)

		2006	2007		2008		2009		2010 F	
		Amount	Amount	% YoY	Amount	% YoY	Amount	% YoY	Amount	% YoY
Cosmax Shanghai	Sales	1.7	4.1	133%	9.3	129%	14.7	57%	25.0	70%
	Net profit	NM	0.5	NM	0.9	69%	1.7	95%	2.5	46%
	Production volume	350	750	114%	1,300	73%	2,000	54%	3,500	75%
Kolmar Beijing	Sales								10.0	-
	Net profit								Loss	-
	Production volume								2,000	-

Source: Cosmax, Kolmar Korea, Korea Investment & Securities

Mamonde ad in China



Source: AmorePacific, Korea Investment & Securities

Laneige ad in China



Source: AmorePacific, Korea Investment & Securities

Time to focus on China

Given the expansion of the mid to low-end markets in China and Korea's competitiveness there, China will become the stage where major Korean cosmetics OEM/ODM players make a strong rebound. Kolmar Beijing with annual production capacity of 20mn units set its first year sales target at W10bn and hopes for an earnings turnaround in 2010. Cosmax Shanghai, which is scheduled to build a second production plant, wishes to increase its annual production capacity from 60mn units to 100mn units with the 2010F sales target at W25bn or up 70% YoY.

V. Cosmetic ingredients industry

On a solid growth path

Cosmetics made from thousands of ingredients

Cosmetics are made from thousands of ingredients such as oxidizing agents (ferric chloride, hydrogen peroxide solution, etc.), preservatives (dorniphen bromide, dmdm hydantoin, etc.), cosmetic astringents (ethanol, alcloxa, aluminium chloride, etc.), humectants (diglycerin, sorbitol, etc.) and sunscreen agents (glyceryl PABA, drometrizole, etc.). According to the Korea Food and Drug Administration (KFDA) regulations, all cosmetics can only use ingredients meeting the relevant standards provided in the Korean Cosmetic Ingredients Directory, International Cosmetic Ingredients Directory, Japan Cosmetic Ingredient Standards, EU Cosmetic Ingredients Directory, the food code and food additives code and the official compendia acknowledged by the KFDA commissioner.

2008-2009 imports of pharmaceutical products

(USD mn)

	2009	2008	YoY
Active pharmaceutical ingredients	1,754	1,904	+92.1%
Finished pharmaceutical products	2,127	2,014	+105.6%
Cosmetics	702	720	+97.6%
In-vitro diagnostic agents	137	139	+99.0%
Cosmetic ingredients	118	106	+11.6%
Non-medical products	99	117	+84.9%
Radio-pharmaceuticals	12	13	+89.1%
Oriental medicinal plants (product test)	59	62	+95.9%
Total	5,009	5,074	+98.7%

Source: Korea Pharmaceutical Traders Association

Cosmetics makers increasingly depend more on imported ingredients

Korea's cosmetics industry grew more than 12% YoY in 2009 but its dependence on imported products and ingredients deepened. According to the Korea Pharmaceutical Traders Association, Korea's imports of cosmetic ingredients increased 11.6% YoY to USD118.3mn in 2009, suggesting Korea is relying more on foreign technology and materials although its market size grew. Given that Korea procures the cosmetic ingredients mainly from developed countries like the US, Japan, Germany and France, we attribute the increase in imports primarily to a lack of technology rather than to cost-cutting moves.

Korea's main import markets for cosmetic ingredients

(USD)

	2009
US	22,199,060
Japan	33,630,004
Germany	20,999,275
France	9,503,425
China	7,168,535
UK	3,355,797
Italy	2,183,655

Source: Korea Pharmaceutical Traders Association

Korea's cosmetic ingredients market size estimated to exceed W600bn in 2010F

Although the ingredient imports are on the rise, Korea's ingredient makers should continue to enjoy solid growth. Korea's high-end cosmetics brands will continue using imported or in-house produced ingredients. But the mid to low-end brands relying on domestic ingredients should keep growing steadily in 2010, driving the growth of the domestic ingredients market. The brand shop market should expand 17% YoY in 2010F thanks to a series of new functional and seasonal cosmetics made by the low to mid-end brands and continued market entries by new firms. In addition, Korean cosmetics' entry to the Chinese market and rapid growth of the private brand market should speed up the growth of the home-grown ingredient makers. At this point, it is difficult to gauge the exact market size due to the lack of reliable industry data. But we peg Korea's cosmetic ingredients market size at W600bn as it represents 7-8% of the total domestic cosmetics market, which is predicted to exceed W8trn in 2010F.

Government measures to nurture the cosmetics industry

Tasks	Detailed measures
Regulatory advance	Implementation of cosmetics ISO GMP (good manufacturing practices)
	Improve the cosmetics packaging guidelines
	Establish cosmetics industry support centers
	Build up public-private cooperation to boost exports
	Establish safety criteria regarding stem-cell cultures
Greater R&D investment	Introduce strict requirements regarding ingredients disclosure
	Provide more R&D support
Stronger policy support	Establish a global cosmetics R&D team
	Provide more policy loans to overhaul manufacturing facilities
	Provide more information regarding product quality tests
	Establish a state-owned skin bank
	Provide support for training quality-control employees
	Promotion of "Global Impacts"

Source: Ministry of Health and Welfare

Government's policy support to spur the ingredients market shuffling

In May, the Korean government announced a set of measures to enhance the competitiveness and stability of the country's cosmetics industry. Aiming at entering the world's top-10 nations in the cosmetics industry, the government plans to strengthen the product quality guidelines to the level of the ISO-GMP (good manufacturing practices) in 2013 and five years later, it will begin compulsory GMP certification. In addition, the government will invest W6bn in 2010 and W11bn in 2011 to support the companies' development of highly functional cosmetics with ingredients from natural origins or oriental herb extracts and to prop up exports.

The government's plans to enforce the global GMP will spur the shuffling of the cosmetic ingredients market in the long run. The policy effects will be limited for comprehensive cosmetics makers using in-house made or imported ingredients. In contrast, smaller companies that currently use low-end ingredients imported from India and China will likely shift to the quality ingredient makers with GMP-certified facilities as they will be required to disclose their products' ingredients. The smaller players will not likely invest directly to build facilities meeting the GMP standards considering the initial cost burden and related risks. That is, we believe the implementation of stricter quality standards and ingredient disclosure requirements will be a barrier to new entrants. Top-ranked ingredients makers with GMP-certified facilities and core competitiveness will become prime beneficiaries of the stricter policies.

Kosdaq-listed ingredient makers are Bioland, Daebong LS and KCI

Aside from the Kosdaq-listed firms Bioland (052260.KQ), Daebong LS (078140.KQ) and KCI (036670.KQ), most cosmetic ingredients makers run small-scale businesses. Specialized in natural extracts, Bioland sells ingredients to about 280 cosmetics makers including AmorePacific, Kolmar Korea and Cosmax and beats the other two listed peers in terms of sales. Bioland has a monopoly in Korea's functional natural ingredients market and sees steady sales growth based on small-scale, batch production.

Daebong LS provides ingredients for hair perm lotions and daily care cosmetics to the OEM and ODM firms like UCL, Cosmax and Kolmar Korea. As UCL, a related company, has grown fast, it has benefited Daebong LS which feeds 50% of UCL's ingredients demand. As the KDFA officially acknowledged alpha-bisabolol, developed jointly between Daebong LS and Bio Spectrum, as a new skin-whitening ingredient in November 2009, it should add to sales beginning in 2H10. Boasting better economic efficiency and stability than arbutin, alpha-bisabolol is anticipated to change the landscape of Korea's skin-whitening cosmetics market worth W250bn.

KCI makes ingredients for hair care products like shampoo and rinse using chemical compounds such as surfactants (dispersion agent) and polymers. KCI's technological prowess is well-recognized as its Polyquata-KC was selected as one of the world's top products by the Ministry of Commerce, Industry and Energy (since renamed the Ministry of Knowledge Economy) in 2H06. KCI's customers include global brands such as L'Oreal and P&G alongside domestic companies such as AmorePacific and LG Household and Health Care. KCI's new ingredients, such as methyl cluceth and hydrogel ester and amidox multicare, which have better moisturizing effects, are expected to take the company's earnings to the next level.

Cosmetics using Bioland's ingredients



Source: Bioland, Korea Investment & Securities

Company

LG Household & Health Care (051900)	25
AmorePacific (090430)	29
Able C&C (078520)	33
Kolmar Korea (024720)	36
Cosmax (044820)	39
Bioland (052260)	42
Daebong LS (078140)	45

LG H&H (051900)

BUY (Maintain), TP: W422,000 (Up)

P&G of Korea, fervently transforming itself

Maintain as top pick, lift TP to W422,000

We lifted our price target by 20.6% from W350,000 to W422,000 due to the following. 1) We raised the 2010F net profit by 15.9% to reflect estimated equity-method gains of W36.3bn from TheFaceShop and upward revision (+4.9%) to Coca-Cola Beverage's (CBC) 2010F operating profit. 2) We reduced the discount to the core operating value that includes LG H&H, TheFaceShop and CCB. In deriving the core operating value, we slashed the discount from 25% to 15% for TheFaceShop as the company has moved beyond the post-acquisition integration period and enjoyed growing expectations for its overseas expansion and waning growth uncertainties. For CCB, we trimmed the discount from 20% to 10% to the global peer average as: 1) its sales have outgrown the sector averages both domestically and globally, 2) its aggressive pursuit of buyout opportunities should lead to fresh growth momentum, and 3) there are growing expectations for an IPO. Our price target equals a 2011F PER of 22.6x using sum-of-parts method.

Despite a 15-month rally, LG H&H trades at a 12MF PER of 20x that is on par with the past five-year average. As such, the valuation is still undemanding compared to its historical PER band. We maintain the counter as our top pick in the cosmetics sector given: 1) numerous growth opportunities from its diverse business portfolio, 2) expectations for overseas expansion, and 3) additional catalysts such as CCB's possible IPO and a strategic alliance with Unilever.

Premium line expansion in household goods bolsters robust growth; Alliance with Unilever is a bonus

LG H&H is enhancing its product portfolio to bolster its top and bottom-line growth. As result, we expect the household goods division to deliver a sales CAGR of 11.6% and an operating profit CAGR of 19.2% during 2009-2012F. The company is also strengthening its brand power by building strategic alliances with global companies. We believe LG H&H has a good track record in this regard. The counter has successfully expanded its presence in the domestic hygiene market through LG Unicharm, a joint venture with Unicharm (Japan). It is now turning to Unilever to tighten its grip on the hair and body care market. The strategic alliance is a win-win strategy for both as loss-making Unilever can take advantage of LG H&H's extensive distribution networks as CBC did in the past and increase its operating margin to the 2-3% level, and LG H&H can increase its hair and body care product market shares by 5%p and 13%p, respectively, (27% market share each as of 2009). Thanks to the Unilever partnership, it can widen the competitive gap with second-tier rivals. But we excluded the probable partnership with Unilever from our earnings estimates as the deal has yet to be sealed. In a conservative estimate, the 2010F net profit would increase 1.2% under K-GAAP.

July 20, 2010 / W350,500 / Mkt cap: USD4,552mn, KRW5,474bn

Yr to	Sales	OP	EBT	NP	EPS	% chg.	EBITDA	P/E	EV/EBITDA	P/B	ROE
Dec	(W bn)	(W bn)	(W bn)	(W bn)	(won)	(YoY)	(W bn)	(x)	(x)	(x)	(%)
2008A	1,355	154	162	121	7,183	49.4	179	26.5	18.1	8.4	27.8
2009A	1,525	198	216	171	10,192	41.9	241	28.6	20.2	9.6	31.0
2010F	1,735	239	316	235	15,640	53.5	283	22.4	21.5	7.8	34.6
2011F	1,962	288	376	279	18,669	19.4	336	18.8	18.0	6.3	33.4
2012F	2,192	329	435	323	21,681	16.1	380	16.2	15.7	5.1	30.9

TheFaceShop goes overseas

In the past, TheFaceShop's overseas sales stood at less than 10% of total sales. But LG H&H seeks to forge partnerships with competent players in China, Eastern Europe and Southeast Asia and foster the overseas market as a new source of revenue. The board of directors recently decided to establish TheFaceShop's Chinese subsidiary in 2H10 to secure a launchpad to the country's cosmetics market. It is too early to pin high hopes but successful Chinese market entry would be a boon for TheFaceShop's value.

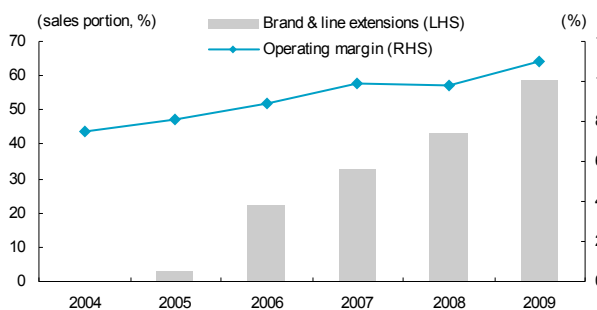
SoP valuation

(W bn)

	Method	Value
Core operating value		6,630.1
LG H&H	17.5x 2010F EBITDA (four-year average of EV/EBITDA)	4,959.1
TheFaceShop	14.9x 2010F EBITDA (LG H&H's core operating business value), 15% discount	756.6
CCB	17x 2010F EBITDA (global beverages average), 10% discount	914.4
Non-operating value	Equity-method subsidiaries	43.3
Net debt		482.9
Fair equity value		6,190.5
Shares outstanding ('000)		14,659.6
Fair equity value per share (won)		422,286.4

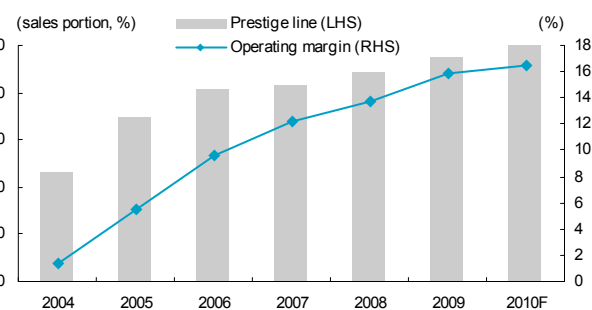
Source: Company data, Korea Investment & Securities

Household goods: Bigger margin on premium brand expansion



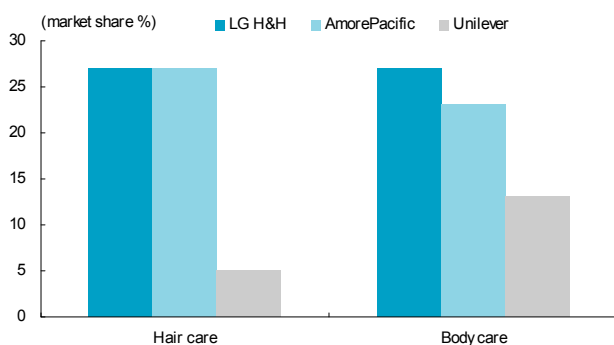
Source: Company data, Korea Investment & Securities

Cosmetics: Bigger margin on prestige line growth



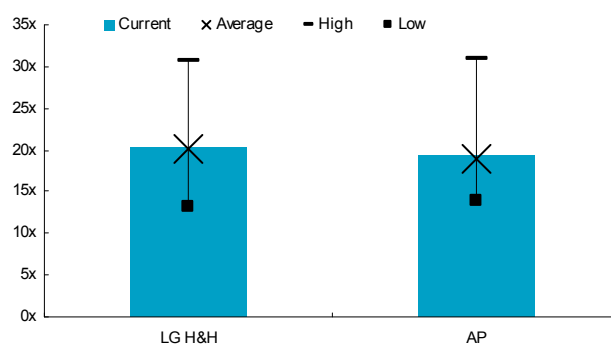
Source: Company data, Korea Investment & Securities

Tighter grip on strategic alliance with Unilever (2009)



Source: Company data, Korea Investment & Securities

12-month-forward PER still at the average



Source: Company data, Quantiwise, Korea Investment & Securities

Risk factors:

Major risks include intensifying competitive pressure in the brand shop market due to the entrance of established cosmetics players and heavier financial leverage due to ongoing M&A activities.

TheFaceShop's financial statement summary

(W bn, %)

	2008	2009	2010F	2011F	2012F
Sales	235	257	286	327	364
Domestic sales	219	234	266	304	338
Exports	16	18	20	23	26
Gross profit	162	176	195	224	250
Operating profit	45	42	55	63	71
Net profit	33	32	41	47	53
EBITDA	48	45	58	66	74
Growth (% YoY)					
Sales	12	9	11	14	11
Domestic sales	11	7	13	14	11
Exports	34	11	11	15	15
Margin (%)					
GP margin	69	68	68	68	69
OP margin	19	16	19	19	20
NP margin	14	12	14	14	15
ROE	26	37	25	46	46
Equity-method gains					
LG H&H PBT contribution	NA	NA	7.2	7.3	7.8
LG H&H NI growth contribution	NA	NA	14.4	13.6	14.5

Source: TheFaceShop, Korea Investment & Securities

CCB's financial statement summary

(W bn, %)

	2008	2009	2010F	2011F	2012F
Sales	535	604	681	749	816
Carbonated beverages	397	441	490	534	573
Non-carbonated beverages	138	163	191	215	243
Gross profit	252	281	318	352	385
Operating profit	38	56	70	83	97
Net profit	37	102	66	77	85
EBITDA	62	80	94	107	121
Growth (% YoY)					
Sales	15.9	13.0	12.7	10.0	8.9
Carbonated beverages	19.4	10.9	11.2	8.9	7.3
Non-carbonated beverages	16.2	18.2	17.3	12.7	12.8
Margin (%)					
GP margin	47.0	46.5	46.8	47.0	47.2
OP margin	7.1	9.3	10.2	11.1	11.9
NP margin	6.8	16.9	9.8	10.2	10.5
ROE	18.4	43.5	26.0	25.5	27.3
Equity-method gains					
Contribution to LG H&H EBT	17.5	19.6	18.9	18.4	17.7
Contribution to LG H&H NP growth	70.4	28.0	27.2	21.0	17.5

Source: CCB, Korea Investment & Securities

Balance Sheet

Fiscal year ending Dec. (W bn)	2008A	2009A	2010F	2011F	2012F
Current assets	331	327	445	503	562
Cash & cash equivalents	23	12	87	98	110
Accounts receivable	152	173	197	223	249
Inventory	123	124	141	159	178
Fixed assets	709	794	1,194	1,299	1,411
Investments	384	487	868	955	1,050
Tangible assets	283	242	252	260	268
Intangible assets	13	12	13	15	17
Total assets	1,040	1,121	1,639	1,802	1,973
Current liabilities	413	422	523	488	482
Accounts payable	94	109	124	140	156
Short-term borrowings	94	60	100	60	60
Current portion of LT debt	80	120	120	120	120
Long-term debt	142	79	379	380	331
Debentures	120	50	350	350	300
Long-term borrowings	0	0	0	0	0
Total liabilities	555	501	902	868	814
Paid-in capital	89	89	89	89	89
Capital surplus	97	97	97	97	97
Capital adjustments	(71)	(71)	(145)	(182)	(236)
Retained earnings	363	500	690	925	1,203
Shareholders' equity	485	620	737	934	1,160

Income Statement

Fiscal year ending Dec. (W bn)	2008A	2009A	2010F	2011F	2012F
Sales	1,355	1,525	1,735	1,962	2,192
Gross profit	753	860	995	1,134	1,266
SG&A expenses	599	662	756	846	937
Operating profit	154	198	239	288	329
Non-op. profit	47	56	111	130	146
Interest income	3	2	4	8	9
FX gains	8	4	2	2	2
Equity gains	32	48	102	117	132
Non-op. expenses	38	38	34	42	40
Interest expenses	20	16	22	31	28
FX losses	5	5	2	2	2
Equity losses	4	1	1	1	1
Earnings before tax	162	216	316	376	435
Income taxes	42	45	81	97	112
Profit from discontinued op.	0	0	0	0	0
Net profit	121	171	235	279	323
EBITDA	179	241	283	336	380

Cash Flow

Fiscal year ending Dec. (W bn)	2008A	2009A	2010F	2011F	2012F
C/F from operations	105	171	194	168	190
Net profit	121	171	235	279	323
Depreciation	22	39	41	43	46
Amortization	4	4	4	4	5
Net incr. in W/C	(26)	(14)	3	(57)	(67)
Others	(15)	(29)	(87)	(102)	(117)
C/F from investing	9	(83)	(345)	(38)	(34)
Capex	(24)	(48)	(52)	(53)	(55)
Decr. in fixed assets	22	0	0	0	0
Net incr. in current assets	6	0	0	0	0
Incr. in investment	7	(21)	(280)	30	36
Others	(1)	(14)	(13)	(14)	(15)
C/F from financing	(102)	(99)	225	(119)	(145)
Incr. in equity	0	0	0	0	0
Incr. in debt	(77)	(64)	340	(40)	(50)
Dividends	(25)	(34)	(42)	(44)	(44)
Others	(0)	(1)	(73)	(35)	(51)
Increase in cash	12	(11)	75	11	11

Key Financial Data

Fiscal year ending Dec.	2008A	2009A	2010F	2011F	2012F
Per-share data (won)					
EPS	7,183	10,192	15,640	18,669	21,681
BPS	22,604	30,342	44,841	55,886	68,504
DPS	2,000	2,500	2,500	2,500	2,500
SPS	80,377	90,470	103,570	117,111	130,789
Growth (%)					
Sales growth	15.5	12.6	13.8	13.1	11.7
OP growth	21.5	29.0	20.5	20.6	14.3
NP growth	50.2	41.9	37.2	18.9	15.8
EPS growth	49.4	41.9	53.5	19.4	16.1
EBITDA growth	16.7	34.3	17.6	18.4	13.2
Profitability (%)					
OP margin	11.3	13.0	13.8	14.7	15.0
NP margin	8.9	11.2	13.5	14.2	14.7
EBITDA margin	13.2	15.8	16.3	17.1	17.3
ROA	11.9	15.8	17.0	16.2	17.1
ROE	27.8	31.0	34.6	33.4	30.9
Dividend yield	1.1	0.9	0.7	0.7	0.7
Stability					
Net debt (W bn)	270	218	483	432	370
Int. coverage (x)	7.7	12.5	10.7	9.4	11.7
D/E ratio (%)	60.6	37.0	77.3	56.7	41.4
Valuation (x)					
PER	26.5	28.6	22.4	18.8	16.2
PBR	8.4	9.6	7.8	6.3	5.1
PSR	2.4	3.2	3.4	3.0	2.7
EV/EBITDA	18.1	20.2	21.5	18.0	15.7

AmorePacific (090430)**BUY (Maintain), TP W1,160,000 (Up)****Prime beneficiary of China's market growth****Lift price target to W1, 160,000; Maintain BUY**

We lift the price target from W1,055,000 to W1,160,000 as we revise up the 2010F operating profit by 4.4% and derived the Chinese subsidiary's value by applying a 2010F EV/Sales multiple of to 6.1x (10% discounted to the global peer average) versus the previous 3x (50% discounted). We reduced the discount rate to the Chinese subsidiary reflecting: 1) diverse brands and sales channels at the Chinese subsidiary, which should lead to new sales, and 2) expectations for a stable net margin of 9.5% despite pressure from the company's expansion drive in 2010. Our price target is the sum of core operating value and the Chinese subsidiary's value, which equal a 2011F PER of 20.4x and PEG of 1.2x. The stock gained sharply in 1H10 but lacks a fresh catalyst for further upswing. Nonetheless, we reiterate BUY from a long-term perspective considering: 1) a solid growth story for the existing business, 2) outstanding operating margin compared to global peers, and 3) accelerating Chinese momentum.

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 slowing domestic demand for department store products as the KRW strengthened against the USD. But in reality, the company's sales at department stores are thought to have grown 14% YoY in 2Q10F, led by duty-free shops. The door-to-door sales should increase 9% YoY in 2Q10F, 2%p greater than what we estimated in early 2010, as the 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 Artaum shops. The full-year opening target of 1,150 Artaum stores was already met in 2Q10. Hence, we expect the company to put more focus on bolstering the top line on the back of same-store sales growth rather than adding shops.

Chinese subsidiary enters the expansionary phase

AmorePacific already dominates the domestic market (35.1% market share in 2009) and thus the Chinese subsidiary's value is a key share price variable. In the near-term, it is important to lift sales after the store additions. As rivals P&G (with the Olay brand), Shiseido (Aupres) and L'Oreal (Paris) generate sales mainly from the mass-market brands, we expect AmorePacific to focus on beefing up the presence of its mass-market Mamonde line by opening 50 department store outlets annually until 2015. At present, the company is working to launch its premium Sulwhasoo line and obtain a door-to-door business license in China. Although the short-term effects are insignificant, we view the efforts as positive steps. We believe the diverse brands and sales channels will establish a foundation for mid to long-term growth.

July 20, 2010 / W985,000 / Mkt cap: USD4788mn, KRW5,758bn

Yr to	Sales	OP	EBT	NP	EPS	% chg.	EBITDA	P/E	EV/EBITDA	P/B	ROE
Dec	(W bn)	(W bn)	(W bn)	(W bn)	(won)	(YoY)	(W bn)	(x)	(x)	(x)	(%)
2008A	1,531	255	244	170	28,225	(4.4)	318	23.2	NM	4.1	16.5
2009A	1,769	301	299	226	37,658	33.4	374	24.8	NM	5.1	18.7
2010F	1,995	359	383	289	48,489	28.8	441	20.3	13.0	4.7	20.8
2011F	2,215	410	447	338	56,812	17.2	498	17.3	11.3	4.3	21.8
2012F	2,436	465	521	394	66,384	16.8	558	14.8	9.8	3.8	22.9

Investment risks

Aside from concerns of profit-taking after a rally, operating-side concerns are limited. AmorePacific may lose some domestic market share to home-grown and foreign rivals. In addition, it may take longer than expected before the company expands its Chinese market share.

Fair value W1,160,000 using SoP valuation

(W bn)

	Calculation	Value
Core operating value		6419.5
AmorePacific	12.5x 2010F EBITDA (three-year average)	5,509.1
AmorePacific China	6.1x 2010F sales ((Global peers average)	910.4
Non-operating value	Equity-method subsidiaries	28.5
Net debt		(332.7)
Fair value		6,780.8
Fair value per share (won)		1,160,543

AmorePacific China's EV/sales	Discount to global peer avg.	Fair value per share	Upside or downside
Scenario 1 3.6x	-40%	1,098,219	11.5%
Scenario 2 4.8x	-20%	1,129,381	14.7%
Scenario 3 6.1x(Base case)	0%	1,160,543	17.8%
Scenario 4 7.3x	+20%	1,191,705	21.0%

Source: Company data, Korea Investment & Securities

Earnings revisions

(W bn, %)

	2010F		2011F		Diff.	
	Previous	Revised	Previous	Revised	2010F	2011F
Sales	1,958.1	1995.4	2,167.4	2214.9	1.9	2.2
Operating profit	344.2	359.3	391.8	409.8	4.4	4.6
Net profit	276.6	289.2	324.0	337.8	4.5	4.3

Source: Korea Investment & Securities

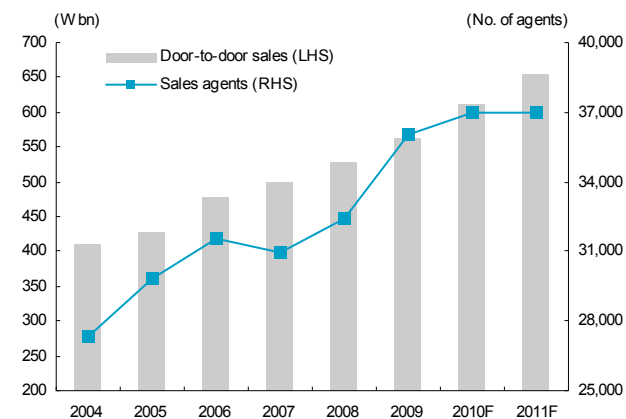
Operating results by business division

(W bn, %)

	1Q09	2Q09	3Q09	4Q09	1Q10	2Q10F	%QoQ	%YoY
Cosmetics Sales	381.0	388.0	355.0	351.0	440.8	434.6	(1.4)	12.0
Operating profit	99.8	76.8	56.0	48.0	121.4	81.0	(33.3)	5.5
OP margin (%)	26.2	19.8	15.8	13.7	27.5	18.6		
MB&S Sales	81.8	64.5	93.0	55.3	94.9	76.3	(22.3)	14.3
Operating profit	11.4	1.9	17.5	(10.8)	11.1	8.1	(27.0)	316.1
OP margin (%)	13.9	3.0	18.8	n/a	11.7	11.0		

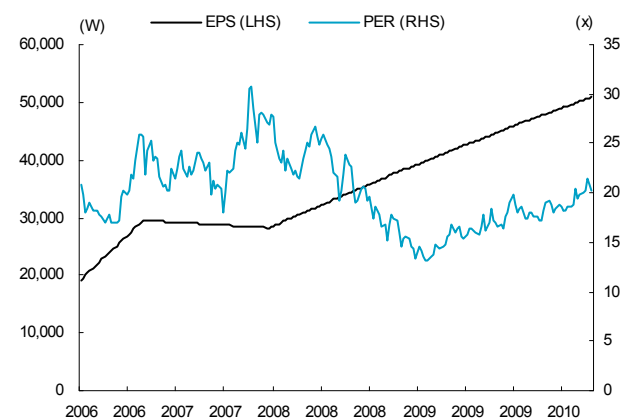
Source: Korea Investment & Securities

Growth of the door-to-door sales channel



Source: Company data, Korea Investment & Securities

12MF EPS and PER: EPS growth outpaces share rise



Source: Quantiwise, 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	0.6	0.6	0.6
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	20.3	17.3	14.8
PBR	4.1	5.1	4.7	4.3	3.8
PSR	2.6	3.2	3.4	3.1	2.8
EV/EBITDA	NM	NM	13.0	11.3	9.8

Able C&C (078520)

Not Rated

A beauty of masstige cosmetics

A pioneer of Korea's low-priced cosmetics market

Able C&C opened Korea's low-priced cosmetics market with its beauty emporium, Missha. In the initial phase of the business, the company quickly expanded its presence thanks to attractively priced offerings but it later faced intense competition as the market fragmented with the entry by new entrants with the same business model. Able C&C scaled down its domestic stores and shifted focus to overseas markets in 2006 but its earnings eroded further due to the decline in the top-line and weakened brand recognition. With the founder and CEO Mr. Young-pil Seo returning to the helm in 2007, the company shored up its domestic market presence and restructured overseas stores. The company returned to a solid growth path thanks to the product renewals and better brand recognition abroad. Able C&C now runs 276 direct stores, 190 "multi-shops", 134 franchised stores and 86 shops situated inside subway stations in Korea and about 460 stores in 21 countries around the world. The company operates two overseas subsidiaries (in China and Japan).

Leadership backed by sales channel additions and diverse product lineup

We point to three reasons for Able C&C's successful comeback and steady leadership of the low to mid-priced cosmetics market. First, the company has secured a new demand base by expanding sales channels from existing road shops to subway stations, big-box outlets, duty-free shops, military posts and the online marketplace. Second, the product mix has diversified thanks to continued development of new products. The ASP has increased steadily backed by its premium line products. Third, the company has differentiated itself from rivals with clever promotions such as biannual sale and the Missha Day discount (10th of every month). The promotion strategies turned out to be effective methods to control inventories and attract customers via word-of-mouth advertising.

Store additions and new products to lead sound 2010 results

Able C&C should continue its stable growth with 2010F sales of W241.3bn (+33.2% YoY) and operating profit of W28.3bn (+46.3% YoY), backed by store additions and new product releases. The company opened 30 additional stores in 1H10 alone, as part of its plan to operate 480 shops (including 20 subway stores, 50 discount stores shops and 20 road shops). Able C&C sold over 3mn Missha M Perfect Cover creams (aka, the red BB, at a selling price of W15,800, 50g) in 2009 and introduced M Signature Real Complete BB, the renewed version (at a selling price of W23,800, 45g) in early 2010. In just one month since release, Able C&C was able to sell more than 100,000 new red BB creams domestically and the robust sales of the product should drive overall sales growth. Net profit should jump 43% YoY to W25.5bn in 2010F thanks to improvement in the equity-method account on robust sales at overseas subsidiaries. The operating margin should gain 1.1%p YoY thanks to the operating leverage on top-line growth and lower advertising spending.

July 20, 2010 / W20,200 / Mkt cap: USD144mn, KRW174bn

Yr to	Sales	OP	EBT	NP	EPS	% chg.	EBITDA	P/E	EV/EBITDA	P/B	ROE
Dec	(W bn)	(W bn)	(W bn)	(W bn)	(won)	(YoY)	(W bn)	(x)	(x)	(x)	(%)
2007A	78	0	(2)	(2)	(293)	(86.3)	3	NA	2.8	0.7	(4.9)
2008A	101	7	11	8	962	(428.1)	11	2.6	0.7	0.5	19.7
2009A	181	19	23	18	2,168	125.2	24	7.6	4.4	2.5	34.0
2010F	241	28	32	25	3,089	42.5	33	6.5	4.2	2.1	34.5
2011F	291	33	38	30	3,307	7.1	39	6.1	3.7	1.7	29.6

Expectations remain valid for the Chinese subsidiary growth

The 100%-owned Chinese subsidiary (established in 2006) delivered sales of W5.1bn (+63.2% YoY) and net profit of W1.5bn (+170.6% YoY) in 2009. Until 2009, the company placed only the Beijing stores under its direct control while it consigned stores in other regions to agents. But the company plans to recover the goodwill for direct operation of the stores in 2010.

The company currently has about 240 stores (including direct stores, department stores and specialty stores) in China and will locate its shops in about 200 Watson's stores in 2H10. The company's target sales and net profit are W15bn (+195.1% YoY) and W2bn (+35.2% YoY), respectively. Profitability should weaken as marketing expenses should increase due to direct operations. Nevertheless, expectations remain valid for the growth of the Chinese subsidiary because the country's mid- to high-priced cosmetics market is expected to prosper thanks to China's growing middle class.

BUY on dips

As the low- to mid-end cosmetics market is still growing, the risks are posed by competition from new entrants and the market fragmentation with low-end brand shops. But we forecast the smaller players, which lack distribution networks and marketing abilities, will eventually fade away. Shares of Able C&C trade at a 2010F PER of 6.5x. The share price has gained more than 70% from its 2010 trough buoyed by expectations for the market's growth and better earnings. Considering possible profit-taking after a good run in the short-term, we believe it will be more rewarding to buy the stock whenever it undergoes corrections rather than to chase the rally.

Balance Sheet

Fiscal year ending Dec. (W bn)	2007A	2008A	2009A	2010F	2011F
Current assets	38	36	60	86	116
Cash & cash equivalents	8	11	15	21	26
Accounts receivable	7	12	17	27	38
Inventory	8	8	14	22	26
Fixed assets	14	26	30	38	46
Investments	0	0	2	2	2
Tangible assets	4	7	7	9	12
Intangible assets	3	3	3	3	3
Total assets	52	62	90	124	162
Current liabilities	11	15	25	33	40
Accounts payable	6	7	11	14	17
Short-term borrowings	1	1	0	0	0
Current portion of LT debt	0	0	0	0	0
Long-term debt	4	3	4	5	5
Debentures	0	0	0	0	0
Long-term borrowings	1	1	1	0	(0)
Total liabilities	14	18	29	38	45
Paid-in capital	4	4	4	4	5
Capital surplus	30	30	30	30	30
Capital adjustments	(2)	(1)	(1)	(1)	(1)
Retained earnings	6	12	29	54	84
Shareholders' equity	37	44	61	87	117

Income Statement

Fiscal year ending Dec. (W bn)	2007A	2008A	2009A	2010F	2011F
Sales	78	101	181	241	291
Gross profit	50	68	127	171	206
SG&A expenses	50	61	108	143	174
Operating profit	0	7	19	28	33
Non-op. profit	2	6	6	5	9
Interest income	0	1	1	1	1
FX gains	0	3	1	0	2
Equity gains	0	2	2	3	4
Non-op. expenses	4	2	2	1	3
Interest expenses	0	0	0	0	0
FX losses	0	1	2	0	1
Equity losses	4	1	0	0	0
Earnings before tax	(2)	11	23	32	38
Income taxes	(1)	3	5	7	8
Profit from discontinued op.	0	0	0	0	0
Net profit	(2)	8	18	25	30
EBITDA	3	11	24	33	39

Cash Flow

Fiscal year ending Dec. (W bn)	2007A	2008A	2009A	2010F	2011F
C/F from operations	5	12	22	19	22
Net profit	(2)	8	18	25	30
Depreciation	1	2	3	4	5
Amortization	1	1	1	1	1
Net incr. in W/C	(3)	2	(1)	(10)	(10)
Others	8	(1)	0	(2)	(4)
C/F from investing	(7)	(8)	(16)	(13)	(17)
Capex	(2)	(5)	(4)	(6)	(8)
Decr. in fixed assets	2	0	0	0	0
Net incr. in current assets	(3)	7	(8)	(3)	(7)
Incr. in investment	(1)	(0)	(1)	3	4
Others	(2)	(10)	(4)	(7)	(6)
C/F from financing	9	(1)	(1)	(0)	1
Incr. in equity	8	0	0	(0)	0
Incr. in debt	(0)	(0)	(1)	(0)	1
Dividends	0	0	(0)	(0)	(0)
Others	1	(1)	(0)	0	0
Increase in cash	7	3	4	6	5

Key Financial Data

Fiscal year ending Dec.	2007A	2008A	2009A	2010F	2011F
Per-share data (won)					
EPS	(293)	962	2,168	3,089	3,307
BPS	4,019	4,603	6,716	9,637	11,998
DPS	0	10	10	10	10
SPS	16,942	14,645	24,128	29,235	32,006
Growth (%)					
Sales growth	(16.3)	28.9	79.1	33.2	20.5
OP growth	(103.4)	2,286.7	167.5	46.3	15.1
NP growth	(87.1)	(589.3)	123.5	43.0	17.8
EPS growth	(86.3)	(428.1)	125.2	42.5	7.1
EBITDA growth	(146.3)	285.4	118.4	40.1	16.7
Profitability (%)					
OP margin	0.4	7.2	10.7	11.7	11.2
NP margin	(2.1)	7.9	9.8	10.6	10.3
EBITDA margin	3.6	10.7	13.1	13.8	13.3
ROA	(3.4)	14.0	23.4	23.8	21.0
ROE	(4.9)	19.7	34.0	34.5	29.6
Dividend yield	0.0	0.4	0.1	0.0	0.0
Stability					
Net debt (W bn)	(16)	(12)	(25)	(34)	(47)
Int. coverage (x)	9.1	162.1	615.6	1,826.8	8,400.7
D/E ratio (%)	4.2	4.6	1.4	0.4	(0.1)
Valuation (x)					
PER	(9.5)	2.6	7.6	6.5	6.1
PBR	0.7	0.5	2.5	2.1	1.7
PSR	0.2	0.2	0.7	0.7	0.6
EV/EBITDA	2.8	0.7	4.4	4.2	3.7

Kolmar Korea (024720)

Not Rated

Finding a new growth driver in China

Korea's No. 1 OEM/ODM cosmetics supplier

Specialized in the original equipment and original design manufacture (OEM/ODM) of cosmetics and pharmaceutical products, Kolmar Korea (Kolmar) offers a total range of services from product planning to finished product shipment. The sales mix consisted of 70% cosmetics and 30% pharmaceuticals in FY09 (fiscal year ends in March). In the cosmetics segment, Kolmar produces about 15,000 products for the supply to 160 domestic customers, including AmorePacific and LG Household & Health Care, and to overseas customers. The company has maintained the number one position in Korea's OEM/ODM cosmetics segment measured by market share. In the pharmaceutical division, the company produces generic drugs (such as anti-inflammatories, blood pressure depressants, digestants and anti-obesity agents), skin medicaments and toothpastes and also serves as an OEM platform. The pharmaceutical division showed a sales CAGR of 52% for the past five years.

Record earnings in FY09 (Apr 09-Mar 10)

Kolmar reported record earnings in FY09 with sales of W188.1bn and operating profit of W13.6bn, up 23% and 56% from a year ago. By division, sales amounted to W131bn for cosmetics and W57.1bn for pharmaceuticals in FY09, up 18% and 34% from FY08. As Korea's biggest OEM/ODM cosmetics supplier, Kolmar has continued to grow along with the market's expansion. The company's cosmetics business has grown not only in size but also in quality as evidenced by the overall increase in sales volume across price ranges. The pharmaceutical business continues to expand as well thanks to greater OEM supplies to major pharmaceutical companies. As the sales contribution of the high-margin pharmaceutical business has expanded, the company's overall operating margin rose 1.5%p YoY to 7.2% in FY09. Net profit jumped a whopping 110% YoY to W11.7bn thanks to W1.7bn in equity-method gains from Sun Biotech, a subsidiary.

FY10F sales and operating profit of W215bn and W18.1bn, respectively

Kolmar should report sales of W215bn (+14% YoY) and operating profit of W18.1bn (+33% YoY) in FY10F. By division, a 12% YoY sales growth should be easily achievable at the cosmetics division because, amid the robust downstream industry environment, Kolmar has added new cosmetics customers including Woongjin Coway. In addition, as the number one OEM/ODM supplier to cosmetics brands, the company should benefit from the growing presence of Korean cosmetics in China. At the pharmaceuticals division, sales should grow 21% YoY as the KFDA's implementation of the itemized pre-GMP evaluation system¹ will require a tighter validation² and subsequently it should lead to a substantial increase in OEM orders from small and midsize drug makers.

July 20, 2010 / W6,800 / Mkt cap: USD1.1mn, KRW14bn

Yr to	Sales	OP	EBT	NP	EPS	% chg.	EBITDA	P/E	EV/EBITDA	P/B	ROE
Mar	(W bn)	(W bn)	(W bn)	(W bn)	(won)	(YoY)	(W bn)	(x)	(x)	(x)	(%)
FY07A	123	7	7	6	267	(33.8)	11	12.3	9.0	1.1	9.0
FY08A	154	9	6	6	258	(3.4)	13	13.2	7.7	1.1	8.0
FY09A	188	14	12	12	437	69.4	18	11.4	7.9	1.4	13.8
FY10F	215	18	18	17	616	41.0	23	11.0	8.6	1.7	15.7
FY11F	244	21	23	20	734	19.1	27	9.3	7.2	1.5	16.7

¹ To review of GMP processes of each item before approval

² To confirm whether an ingredient or a drug is capable of generating the required quality

As major pharmaceutical companies are likely to increase their dependence on OEM, we expect the OEM business to drive pharmaceutical sales growth beginning in 2010.

The operating margin should surpass the 8% mark in 2010F thanks to the operating leverage effects and the greater sales contribution of pharmaceuticals. Net profit should jump 41% YoY to W16.5bn on the back of brisk growth of Sun Biotech, a subsidiary. As a manufacturer of health supplementary food and cosmetics, Sun Biotech's sales doubled from W10bn in FY08 (fiscal year ends in March) to W20.1bn in FY09. Sun Biotech targets sales of W28bn in FY10F on the start of exports to China and the US.

Chinese market entry, a new growth engine

The Chinese market entry is gathering pace on Beijing Kolmar's start of full-fledged operations in 2010. Targeting the Chinese domestic market, Beijing Kolmar places its sales focus on skin care and color cosmetics. The Chinese subsidiary is expected to report sales of W10bn in the first year of business with an annual capacity of 20,000 products. Given the ample growth potential of the Chinese cosmetics market, we believe Beijing Kolmar will drive the company's growth particularly when the domestic market's growth moderates.

PER of 11.0x and 2010F EPS of W616

Kolmar shares trade at a PER of 11.0x the 2010F EPS of W616. We believe the stock has abundant merits for investment at the current valuation given its continuing earnings momentum, stable downstream (cosmetics and pharmaceuticals) industries and the start of full-scale operations of the Chinese plant. As the share price has jumped more than 80% since the beginning of 2010, there is likely to be some profit-taking. Therefore, it should prove more rewarding to accumulate the stock when it undergoes corrections rather than to chase the rally. Regarding the BWs worth W5bn (with the exercise price of W3,753/share) issued in January, concerns over share overhang appears insignificant as the major shareholders hold 80% of the warrants.

Balance Sheet

Fiscal year ending Mar. (W bn)	FY07A	FY08A	FY09A	FY10F	FY11F
Current assets	56	67	78	83	97
Cash & cash equivalents	17	22	18	19	24
Accounts receivable	22	27	31	32	39
Inventory	10	13	17	18	20
Fixed assets	80	85	91	96	101
Investments	30	31	31	32	34
Tangible assets	46	50	56	60	63
Intangible assets	2	2	1	1	2
Total assets	136	153	169	179	199
Current liabilities	55	69	62	57	58
Accounts payable	13	22	24	26	27
Short-term borrowings	3	11	12	12	11
Current portion of LT debt	34	29	18	19	20
Long-term debt	13	11	8	10	11
Debentures	0	1	1	1	2
Long-term borrowings	11	7	4	5	6
Total liabilities	68	80	71	67	69
Paid-in capital	11	11	13	14	14
Capital surplus	26	26	39	39	39
Capital adjustments	0	(0)	(0)	(0)	(0)
Retained earnings	32	35	45	59	76
Shareholders' equity	68	72	98	112	130

Income Statement

Fiscal year ending Mar. (W bn)	FY07A	FY08A	FY09A	FY10F	FY11F
Sales	123	154	188	215	244
Gross profit	20	26	36	44	51
SG&A expenses	14	17	22	26	29
Operating profit	7	9	14	18	21
Non-op. profit	3	3	5	5	6
Interest income	1	1	0	0	1
FX gains	0	1	1	1	1
Equity gains	1	1	3	3	4
Non-op. expenses	3	6	7	5	4
Interest expenses	2	3	2	2	2
FX losses	1	2	1	1	1
Equity losses	0	1	1	1	1
Earnings before tax	7	6	12	18	23
Income taxes	1	1	0	2	3
Profit from discontinued op.	0	0	0	0	0
Net profit	6	6	12	17	20
EBITDA	11	13	18	23	27

Cash Flow

Fiscal year ending Mar. (W bn)	FY07A	FY08A	FY09A	FY10F	FY11F
C/F from operations	6	12	12	11	15
Net profit	6	6	12	17	20
Depreciation	4	4	4	5	5
Amortization	0	0	1	0	0
Net incr. in W/C	(4)	(1)	(7)	(9)	(8)
Others	1	4	2	(2)	(3)
C/F from investing	(16)	(6)	(16)	(9)	(8)
Capex	(3)	(8)	(11)	(9)	(8)
Decr. in fixed assets	3	0	0	0	0
Net incr. in current assets	(1)	3	(7)	(1)	(1)
Incr. in investment	(12)	(1)	2	1	2
Others	(3)	(0)	(1)	(1)	(1)
C/F from financing	14	(1)	(1)	(0)	(2)
Incr. in equity	0	0	0	0	0
Incr. in debt	16	0	2	2	1
Dividends	(2)	(2)	(2)	(3)	(3)
Others	0	1	(0)	(0)	0
Increase in cash	4	5	(5)	2	5

Key Financial Data

Fiscal year ending Dec.	FY07A	FY08A	FY09A	FY10F	FY11F
Per-share data (won)					
EPS	267	258	437	616	734
BPS	3,058	3,232	3,613	4,028	4,654
DPS	90	90	95	100	100
SPS	5,661	7,102	7,002	8,010	8,861
Growth (%)					
Sales growth	44.2	25.3	22.5	14.3	13.5
OP growth	78.4	29.3	55.6	33.3	18.9
NP growth	(30.0)	(3.5)	110.4	40.8	22.2
EPS growth	(33.7)	(3.4)	69.4	41.0	19.1
EBITDA growth	43.3	20.3	40.0	26.5	16.3
Profitability (%)	12.3				
OP margin	5.5	5.7	7.2	8.4	8.8
NP margin	4.7	3.6	6.2	7.7	8.3
EBITDA margin	8.8	8.5	9.7	10.7	11.0
ROA	4.5	3.9	7.3	9.5	10.7
ROE	9.0	8.0	13.8	15.7	16.7
Dividend yield	2.7	2.6	1.9	1.5	1.5
Stability					
Net debt (W bn)	26	27	10	10	5
Int. coverage (x)	3.5	2.9	6.2	9.6	10.9
D/E ratio (%)	69.6	68.1	36.0	33.3	29.6
Valuation (x)					
PER	12.3	13.2	11.4	11.0	9.3
PBR	1.1	1.1	1.4	1.7	1.5
PSR	0.6	0.5	0.7	0.8	0.8
EV/EBITDA	9.0	7.7	7.9	8.6	7.2

Cosmax (044820)

Not Rated

China growth story still valid

Specialized in OEM/ODM cosmetics

Cosmax, along with Kolmar Korea, serves as Korea's leading OEM/ODM supplier of cosmetics. Established in 1992, Cosmax acquired the health supplementary food manufacturer Iljin Pharmaceuticals in 2006 and added a toothpaste and toothbrush maker 3A Pharm as an affiliate in 2008. The company's 1Q10 cosmetics sales consisted of 42.6% skin care cosmetics, 35.6% color cosmetics and 21.8% others, and its ODM sales accounted for over 90% of total sales. Cosmax caters to more than 130 companies which include domestic clients such as Somang Cosmetics, AmorePacific, LG Household & Health Care, Able C&C, and TheFaceShop, as well as overseas giants such as L'Oréal, Johnson & Johnson, and Mary Kay. Exports made up 17.5% of total sales in end-1Q10. Cosmax's business is vertically integrated from product development, production, packaging to transport, which is possible through its affiliates such as 3AC (a manufacturer of functional containers for cosmetics), 3AG (overseas marketing) and 3A TSM (logistics and equipment).

Brisk growth continues backed by technological prowess

Cosmax is the only ODM cosmetics supplier in Korea that runs two separate research centers: Central Research Laboratory and Oriental Cosmetics Research Laboratory. The company is focusing its efforts on R&D as 27% of its workforce is engaged in R&D. Technological advancement through bold investments has led to new product releases, which helps strengthen tie-ups with clients and forms a high barrier to new OEM entrants. Backed by the technological prowess, Cosmax has continued to thrive with a sales CAGR of 25.5% since 2005.

2010F earnings outlook

Cosmax should continue to enjoy solid growth with 2010F sales of W150bn (+17.5% YoY), operating profit of W7.8bn (+15.6% YoY) and net profit of W7.7bn (+16.4% YoY). Our upbeat forecast is backed by the following. First, there are a series of launches of mid to low-priced cosmetics brands (Tonymoly, Holika Holika, etc.) that focus on distribution and retail sales while outsourcing production. Second, cosmetics packages and body slimming products are hot sellers on home shopping channels. Third, the company's clients are releasing more premium cosmetics and new products amid the booming cosmetics market. Fourth, exports should increase and the Chinese subsidiary (Cosmax Shanghai) should grow fast thanks to robust consumption backed by rising incomes.

July 20, 2010 / W6,470 / Mkt cap: USD4mn, KRW6bn

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 (%)
2007A	71	2	0	1	96	(54.3)	4	30.5	14.6	1.3	3.9
2008A	93	5	2	2	193	101.0	7	7.8	6.1	0.6	7.6
2009A	128	7	8	7	595	208.3	9	8.0	8.8	1.4	18.6
2010F	150	8	9	8	597	0.4	10	10.8	10.9	1.8	16.6
2011F	172	9	10	9	688	15.1	12	9.4	9.7	1.6	17.3

Growth of the Chinese subsidiary merits a look

Cosmax is Korea's first OEM/ODM cosmetics supplier to make a foray into China. Instead of exporting products to China, Cosmax's Chinese subsidiary produces products tailored to Chinese consumers. In the initial phase of the Chinese market entry, most of the sales were made to non-Chinese foreign companies, whereas it now generates 80% of the sales from high-margin Chinese clients. The ODM supplies make up 90% of the Chinese subsidiary's sales. When the Chinese subsidiary commenced full-scale operation in 2006, sales came in at W1.7bn and it grew 8.4 times to reach W14.7bn in 2009. The Chinese subsidiary reported sales of RMB27.8mn (+89.7% YoY) and operating profit of RMB3.2mn (+193.0% YoY) in 1Q10. The 2010F target sales are RMB150mn (+70.3% YoY).

To serve the rapidly increasing ODM orders, Cosmax is building the no. 2 plant (13,000 m²) beside the no. 1 plant (11,000 m²). When construction of the no. 2 plant is completed in 2011, the Chinese subsidiary will have an annual capacity of 100mn units of cosmetics, up 40% from the current level. In addition, the company recently signed a contract to rent land (26,640 m²) in Guangzhou (Guangdong Province) to build the no. 3 plant. Guangdong Province has a bigger cosmetics market than does Shanghai. As the province is densely populated with cosmetic companies, having a factory in the region is advantageous in terms of logistics. The company plans to expand the Guangzhou plant's production capacity to 100mn units to match Shanghai's.

Trades at a 2010F PER of 10.8x

Cosmax's main strengths are advanced technology (49 patents and 1,973 approvals for functional cosmetics) and its early mover advantage in China, which gives it a head start in the world's fastest-growing consumer market. As China's cosmetics market is rapidly expanding, we expect the company to benefit from surging demand from producers thanks to its sound quality control and technological acumen, which are lacking in Chinese cosmetics companies. The stock trades at a 2010F PER of 10.8x, compared to Kolmar Korea's 11.0x, the OEM/ODM co-leader. The stock merits little attention in terms of valuations, but we still believe a positive approach is rewarding because the company penetrated the lucrative Chinese cosmetics market ahead of rivals and has grown briskly there.

Balance Sheet

Fiscal year ending Dec. (W bn)	2007A	2008A	2009A	2010F	2011F
Current assets	33	37	51	63	72
Cash & cash equivalents	0	1	3	4	5
Accounts receivable	19	17	24	31	35
Inventory	6	7	11	12	14
Fixed assets	41	47	55	63	73
Investments	9	15	16	18	21
Tangible assets	31	31	37	43	50
Intangible assets	0	1	1	1	1
Total assets	74	84	106	126	145
Current liabilities	31	48	54	67	78
Accounts payable	4	5	8	10	11
Short-term borrowings	14	19	29	38	45
Current portion of LT debt	3	12	1	1	1
Long-term debt	17	8	8	9	9
Debentures	0	0	0	0	0
Long-term borrowings	13	4	3	3	2
Total liabilities	49	56	62	76	88
Paid-in capital	5	5	6	7	7
Capital surplus	10	10	14	14	14
Capital adjustments	(1)	(1)	(0)	(0)	(0)
Retained earnings	11	13	19	24	31
Shareholders' equity	26	28	44	50	57

Income Statement

Fiscal year ending Dec. (W bn)	2007A	2008A	2009A	2010F	2011F
Sales	71	93	128	150	172
Gross profit	8	12	18	21	24
SG&A expenses	6	7	11	13	15
Operating profit	2	5	7	8	9
Non-op. profit	1	3	8	7	7
Interest income	0	0	1	1	1
FX gains	0	0	1	1	1
Equity gains	0	1	2	3	4
Non-op. expenses	4	6	7	6	6
Interest expenses	2	2	2	2	2
FX losses	1	2	0	0	0
Equity losses	1	0	4	2	1
Earnings before tax	0	2	8	9	10
Income taxes	(1)	(0)	1	1	1
Profit from discontinued op.	0	0	0	0	0
Net profit	1	2	7	8	9.2
EBITDA	4	7	9	10	12

Cash Flow

Fiscal year ending Dec. (W bn)	2007A	2008A	2009A	2010F	2011F
C/F from operations	1	9	2	4	8
Net profit	1	2	7	8	9
Depreciation	1	2	2	2	3
Amortization	0	0	0	0	0
Net incr. in W/C	(4)	1	(8)	(5)	(2)
Others	2	4	2	(1)	(3)
C/F from investing	(9)	(10)	(3)	(11)	(12)
Capex	(4)	(2)	(3)	(8)	(10)
Decr. in fixed assets	0	1	0	0	0
Net incr. in current assets	(1)	(6)	(1)	(2)	(2)
Incr. in investment	(4)	(2)	2	(1)	0
Others	0	(1)	(0)	(1)	(1)
C/F from financing	7	1	2	8	4
Incr. in equity	0	0	5	1	0
Incr. in debt	7	2	(3)	9	6
Dividends	(2)	(1)	(1)	(2)	(2)
Others	1	(0)	1	0	0
Increase in cash	(1)	1	2	1	1

Key Financial Data

Fiscal year ending Dec.	2007A	2008A	2009A	2010F	2011F
Per-share data (won)					
EPS	96	193	595	597	688
BPS	2,258	2,384	3,452	3,631	4,148
DPS	50	70	160	160	160
SPS	6,746	8,824	11,452	11,607	12,871
Growth (%)					
Sales growth	33.1	31.0	37.2	17.5	14.6
OP growth	(35.9)	108.9	38.0	15.6	14.1
NP growth	(53.6)	101.4	225.9	16.4	19.0
EPS growth	(54.3)	101.0	208.3	0.4	15.1
EBITDA growth	(21.5)	73.1	32.7	16.0	16.6
Profitability (%)					
OP margin	3.3	5.3	5.3	5.2	5.2
NP margin	1.4	2.2	5.2	5.1	5.3
EBITDA margin	5.4	7.1	6.9	6.8	6.9
ROA	1.5	2.6	7.0	6.7	6.8
ROE	3.9	7.6	18.6	16.6	17.3
Dividend yield	1.7	4.6	3.3	2.6	2.6
Stability					
Net debt (W bn)	25	26	19	25	28
Int. coverage (x)	1.5	2.3	3.6	3.8	3.6
D/E ratio (%)	121.8	127.7	74.4	83.4	83.6
Valuation (x)					
PER	30.5	7.8	8.0	10.8	9.4
PBR	1.3	0.6	1.4	1.8	1.6
PSR	0.4	0.2	0.4	0.6	0.5
EV/EBITDA	14.6	6.1	8.8	10.9	9.7

Bioland (052260)

Not Rated

Food materials to drive growth in 2010

Offering raw materials for cosmetics and foodstuffs

Bioland makes ingredients for cosmetics, foodstuffs, pharmaceuticals and nutraceuticals. The cosmetics segment, making up more than 60% of total sales, deals with small volumes but a wide range of products. The product mix of about 400 items includes natural plant extracts such as portulaca oleracea (moisturizer), chemical synthetics such as arbutin (an essential additive in aesthetic whitening cosmetics) and hyaluronic acids produced by microbial fermentation. The company expanded production capacity in 2004 by taking over a plant in Ansan, Gyeonggi province, from AmorePacific. It now serves approximately 300 cosmetics companies at home and abroad including AmorePacific, LG H&H and Coreana. Cosmetics companies are very loyal to ingredient suppliers for reliability and safety reasons and this is a boon for the company. The continuous launch of new cosmetics containing natural extracts or skin whitening ingredients caters to increasingly health-conscious consumers and thus strengthens the company's earnings stability.

2010F sales of W63.2bn and OP of W16.3bn

We expect the 2010F sales and operating profit to jump 24% YoY and 47% YoY, respectively, to W63.2bn and W16.3bn. The company's guidance is W65bn for sales and W17.5bn for operating profit.

We expect the food materials segment to be a growth driver in 2010. The company has been an exclusive supplier of dulcis extract to Korea Yakult to make Kupffers (health supplement food) and is seeing greater dulcis extract sales on the runaway popularity of Kupffers. Korea Yakult lifted its Kupffers sales target for 2010 to W200bn, up more than 100% from 2009, and has delivered monthly sales of W15bn so far. Given this, we expect Bioland's dulcis extract sales to reach more than W6bn in 2010F. In addition, the company is enjoying greater ginseng extract powder supply to Saimdang and Hamsoa Pharmaceutical and started selling hyaluronic acids to Kwangdong Pharmaceutical to make a renewed version of the revitalizing drink Vita 500. As such, we expect Bioland's food materials sales to almost double to W22.5bn in 2010F from a year earlier.

Hyaluronic acids can be used as both food materials and ingredients for arthritis treatment. The domestic hyaluronic acids market is estimated at W20bn and depends on imports for most of its needs. If the company begins hyaluronic acids production in earnest in 2H10 after winning approval from the Korea Food & Drug Administration (pending), it will be able to replace imports. The company's cosmetics segment has steady and stable earnings thanks to the exclusive supply of ingredients (mainly natural extracts) to clients. We expect the company's 2010F ingredient sales for cosmetics and pharmaceuticals to improve.

July 20, 2010 / W9,440 / Mkt cap: USD118mn, KRW142bn

Yr to	Sales	OP	EBT	NP	EPS	% chg.	EBITDA	P/E	EV/EBITDA	P/B	ROE
Dec	(W bn)	(W bn)	(W bn)	(W bn)	(won)	(YoY)	(W bn)	(x)	(x)	(x)	(%)
2007A	31	6	6	6	429	(0.5)	9	10.8	7.0	1.5	14.8
2008A	37	8	8	6	427	(0.6)	10	7.2	4.5	0.9	12.9
2009A	51	11	12	11	733	71.7	14	8.2	6.3	1.5	19.4
2010F	63	16	17	15	1,002	36.8	19	9.4	7.4	1.9	21.8
2011F	76	20	20	18	1,203	20.0	24	7.8	6.0	1.6	21.8

The rapid growth of the food materials segment should lead to a change in the sales mix. The dependence on cosmetics ingredient sales should dwindle from 62% in 2009 to 51% in 2010F while the portion of food materials rises from 22% to 35% during the same period. From a mid to long-term perspective, the company can benefit from a more balanced product portfolio.

Bio business (diagnostic kits & tissue engineering) a long-term growth driver

The company produces more than 60 diagnostic kits for infections, parasites, drugs, hepatitis and cancer, and its major export destinations are Southeast Asian countries. It also provides tissue engineering products such as the treatment of corneal scars, cut and burn wounds and dental fillers. Bio sales reached W4.2bn in 2009, nearly treble the figure a year earlier. But among the sales was a W3bn one-off gain from H1N1 virus treatment. The 2010F bio sales are expected to surpass W3bn on the back of diagnostic kit exports growth and the supply of tissue engineering products to large hospitals in Korea. Given the one-off growth factor in 2009, the sales estimate for 2010 appears significant.

2010F PER of 9.4x the 2010F EPS of W1,002

The stock trades at a PER of 9.4x the 2010F EPS of W1,002. Despite the sharp rally of more than 50% since early 2010 (taking 100% bonus issue on May 20 into account), the stock still has appeal based on greater demand for food materials, the launch of new pharmaceuticals and safe cosmetics ingredients.

Balance Sheet

Fiscal year ending Dec. (W bn)	2007A	2008A	2009A	2010F	2011F
Current assets	29	25	36	44	55
Cash & cash equivalents	8	8	7	9	11
Accounts receivable	5	7	12	14	17
Inventory	6	9	11	14	18
Fixed assets	30	40	40	53	60
Investments	3	9	7	9	10
Tangible assets	24	28	30	41	45
Intangible assets	0	0	0	0	0
Total assets	59	66	76	97	115
Current liabilities	6	10	9	15	19
Accounts payable	1	1	1	2	2
Short-term borrowings	3	6	4	10	14
Current portion of LT debt	1	1	2	3	3
Long-term debt	5	4	5	5	6
Debentures	0	0	0	0	0
Long-term borrowings	3	2	2	1	1
Total liabilities	11	15	14	21	25
Paid-in capital	4	4	4	8	8
Capital surplus	23	23	23	23	23
Capital adjustments	0	0	0	0	0
Retained earnings	21	26	35	46	59
Shareholders' equity	48	51	62	76	90

Income Statement

Fiscal year ending Dec. (W bn)	2007A	2008A	2009A	2010F	2011F
Sales	31	37	51	63	76
Gross profit	15	18	24	31	38
SG&A expenses	9	10	13	15	17
Operating profit	6	8	11	16	20
Non-op. profit	1	2	3	2	2
Interest income	0	0	0	0	0
FX gains	0	1	0	1	1
Equity gains	0	0	0	0	0
Non-op. expenses	1	2	2	1	2
Interest expenses	0	0	0	0	1
FX losses	0	0	0	1	1
Equity losses	0	0	0	0	0
Earnings before tax	6	8	12	17	20
Income taxes	0	1	1	2	2
Profit from discontinued op.	0	0	0	0	0
Net profit	6	6	11	15	18
EBITDA	8	10	14	19	24

Cash Flow

Fiscal year ending Dec. (W bn)	2007A	2008A	2009A	2010F	2011F
C/F from operations	6	6	6	11	13
Net profit	6	6	11	15	18
Depreciation	2	2	2	2	3
Amortization	0	0	0	0	0
Net incr. in W/C	(3)	(4)	(7)	(6)	(9)
Others	1	1	(0)	(0)	0
C/F from investing	(11)	(6)	(5)	(15)	(11)
Capex	(2)	(6)	(4)	(13)	(8)
Decr. in fixed assets	0	0	0	0	0
Net incr. in current assets	(9)	2	2	(1)	(1)
Incr. in investment	0	(2)	(2)	(2)	(2)
Others	(1)	(0)	(1)	0	(1)
C/F from financing	11	0	(3)	6	0
Incr. in equity	13	0	0	4	0
Incr. in debt	(1)	2	(2)	6	5
Dividends	(1)	(2)	(2)	(2)	(5)
Others	0	0	0	(2)	0
Increase in cash	6	0	(2)	3	2

Key Financial Data

Fiscal year ending Dec.	2007A	2008A	2009A	2010F	2011F
Per-share data (won)					
EPS	429	427	733	1,002	1,203
BPS	3,156	3,399	4,111	5,061	5,962
DPS	200	200	300	300	300
SPS	4,582	4,895	6,794	4,212	5,054
Growth (%)					
Sales growth	13.7	18.8	38.7	24.0	20.0
OP growth	17.3	31.1	43.5	47.4	25.4
NP growth	15.2	10.6	71.7	36.8	20.0
EPS growth	9.3	(0.6)	71.7	36.8	20.0
EBITDA growth	5.4	20.9	32.5	38.9	26.6
Profitability (%)					
OP margin	19.0	21.0	21.7	25.8	27.0
NP margin	18.7	17.4	21.6	23.8	23.8
EBITDA margin	27.3	27.8	26.6	29.8	31.4
ROA	11.4	10.3	15.5	17.4	17.0
ROE	14.8	12.9	19.4	21.8	21.8
Dividend yield	2.2	3.3	2.5	3.2	3.2
Stability					
Net debt (W bn)	(10)	(0)	(5)	(2)	0
Int. coverage (x)	15.4	22.0	32.1	32.7	22.1
D/E ratio (%)	14.0	16.3	11.0	17.3	19.6
Valuation (x)					
PER	10.8	7.2	8.2	9.4	7.8
PBR	1.5	0.9	1.5	1.9	1.6
PSR	2.0	1.3	1.8	2.2	1.9
EV/EBITDA	7.0	4.5	6.3	7.4	6.0

Daebong LS (078140)

Not Rated

Whitening agent alpha-bisabolol to be a long-term growth engine

Producing raw materials for pharmaceuticals and cosmetics

Daebong LS manufactures raw materials for pharmaceuticals and cosmetics. In its pharmaceuticals segment, the company makes material medicines used to treat respiratory and liver diseases and sells to approximately 70 pharmaceutical companies. The company also provides cosmetics materials for permanent wave and basic skin care products for its affiliate UCL, in which Daebong LS CEO Jin Oh Park is the largest shareholder, and for other cosmetics OEM and ODM such as Cosmax and Kolmar Korea. As of 2009, the pharmaceutical and cosmetics segments equally contribute to sales. The company is a formal agent for multinationals such as BASF, Cognis and Merck and sells some raw materials as merchandise, which accounts for 48% of sales as of 2009. The profitability of merchandise is susceptible to FX changes but is usually on par with an average product (13% as of 2009).

2010F sales of W32.5bn and OP of W3.9bn

We expect the 2010F sales and operating profit to increase 12% and 2%, respectively, to W32.5bn and W3.9bn. The company's guidance is W33bn for sales and W4bn for operating profit.

We expect both pharmaceutical and cosmetics segments to be growth engines. The pharmaceuticals segment has delivered stable growth and should generate greater sales thanks to the full-fledged sale of raw materials for diabetes treatments beginning in 2010. In addition, the cosmetics segment that drove the growth in 2009 should see a new sales contribution from alpha-bisabolol, an ingredient for whitening cosmetics, on the back of strong demand from downstream industries. The Korea Food & Drug Administration announced alpha-bisabolol, jointly developed by Daebong LS and Bio Spectrum, as a new whitening cosmetics ingredient in November 2009 and allowed the use of alpha-bisabolol as an alternative to arbutin, an existing ingredient. The new ingredient is reportedly safer and cheaper than arbutin and is expected to change the landscape of the W250bn domestic whitening cosmetics market. We expect the sale of alpha-bisabolol to start from 2H10 in earnest as it usually takes six to 12 months for cosmetics makers to complete safety tests. Daebong LS hopes to generate W1bn-2bn in alpha-bisabolol sales in 2010F and the annual sales to rise to W5bn down the road.

Despite the upbeat sales outlook, the operating margin is expected to shrink to the 12% level due to investment (W3bn), depreciation and labor cost increases from the mandatory introduction of good manufacturing practices (GMP) and validation for pharmaceutical raw materials in 2010. But a smaller operating margin is inevitable amid the institutional change that will ultimately boost the company's competitiveness over the mid to long-term.

July 20, 2010 / W4,040 / Mkt cap: USD14mn, KRW18bn

Yr to	Sales	OP	EBT	NP	EPS	% chg.	EBITDA	P/E	EV/EBITDA	P/B	ROE
Dec	(W bn)	(W bn)	(W bn)	(W bn)	(won)	(YoY)	(W bn)	(x)	(x)	(x)	(%)
2007A	20	2	2	2	393	3.2	3	11.5	7.1	1.2	10.9
2008A	27	3	3	2	530	34.9	3	4.4	2.4	0.6	13.3
2009A	29	4	4	3	779	47.0	4	5.6	3.2	0.9	17.0
2010F	32	4	4	4	833	7.0	4	4.8	2.9	0.7	15.8
2011F	37	5	5	4	968	16.1	5	4.2	2.3	0.6	15.9

2010F PER of 4.8x based on the 2010F EPS of W833

The stock is undervalued at a PER of 4.8x the 2010F EPS of W833. Except for 2006, the company has delivered steady growth and maintained an operating margin of more than 10%. We expect the company to shift its focus from hair care materials to raw materials for basic skin care and functional cosmetics in line with the growth of UCL and the launch of alpha-bisabolol. Considering a large portion of whitening cosmetics in total functional cosmetics and value-added whitening cosmetics materials, alpha-bisabolol should play a key role in driving future growth.

The company issued convertible bonds worth W5bn in February 2010 that bond holders can convert into 1,148,768 shares at an exercise price of W3,980 during Mar 25, 2010-Jan 25, 2013. This equals 26% of all shares outstanding and presents some overhang concerns. If assuming 100% bond conversion, the company's 2010F PER rises to 6.2x.

Balance Sheet

Fiscal year ending Dec. (W bn)	2007A	2008A	2009A	2010F	2011F
Current assets	13	16	19	21	24
Cash & cash equivalents	1	2	5	5	6
Accounts receivable	7	9	9	10	11
Inventory	4	5	4	5	6
Fixed assets	5	5	6	10	12
Investments	0	0	1	1	1
Tangible assets	5	5	5	9	11
Intangible assets	0	0	0	0	0
Total assets	18	22	25	31	36
Current liabilities	2	3	3	5	7
Accounts payable	1	2	2	3	3
Short-term borrowings	0	0	0	0	0
Current portion of LT debt	0	0	0	0	0
Long-term debt	0	0	0	0	0
Debentures	0	0	0	0	0
Long-term borrowings	0	0	0	0	0
Total liabilities	2	3	4	6	7
Paid-in capital	2	2	2	2	2
Capital surplus	4	4	4	4	4
Capital adjustments	0	0	0	0	0
Retained earnings	10	12	15	18	22
Shareholders' equity	16	18	21	25	29

Income Statement

Fiscal year ending Dec. (W bn)	2007A	2008A	2009A	2010F	2011F
Sales	20	27	29	32	37
Gross profit	4	5	6	7	8
SG&A expenses	2	3	3	3	3
Operating profit	2	3	4	4	5
Non-op. profit	0	0	0	1	1
Interest income	0	0	0	0	0
FX gains	0	0	0	0	0
Equity gains	0	0	0	0	0
Non-op. expenses	0	0	0	0	0
Interest expenses	0	0	0	0	0
FX losses	0	0	0	0	0
Equity losses	0	0	0	0	0
Earnings before tax	2	3	4	4	5
Income taxes	0	1	1	1	1
Profit from discontinued op.	0	0	0	0	0
Net profit	2	2	3	4	4
EBITDA	2	3	4	4	5

Cash Flow

Fiscal year ending Dec. (W bn)	2007A	2008A	2009A	2010F	2011F
C/F from operations	(1)	1	4	5	4
Net profits	2	2	3	4	4
Depreciation	0	0	0	0	0
Amortization	0	0	0	0	0
Net incr. in W/C	(4)	(2)	(0)	0	(1)
Others	0	1	0	0	0
C/F from investing	(1)	(0)	(0)	(5)	(2)
Capex	(0)	(0)	(0)	(5)	(2)
Decr. in fixed assets	0	0	0	0	0
Net incr. in current assets	(1)	0	0	(0)	(0)
Incr. in investment	(0)	(0)	(0)	(0)	(0)
Others	(0)	0	0	0	(0)
C/F from financing	(0)	(0)	(0)	(0)	(0)
Incr. in equity	0	0	0	0	0
Incr. in debt	(0)	(0)	0	0	0
Dividends	(0)	(0)	(0)	(0)	(0)
Others	0	0	(0)	(0)	0
Increase in cash	(3)	1	3	(0)	1

Key Financial Data

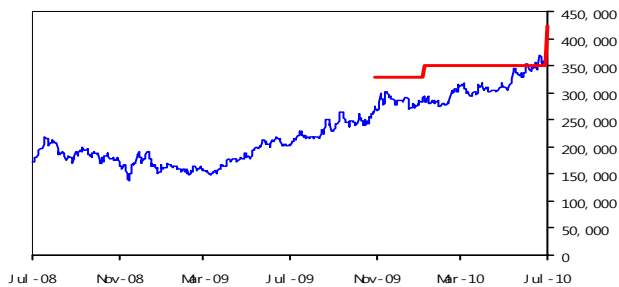
Fiscal year ending Dec.	2007A	2008A	2009A	2010F	2011F
Per-share data (won)					
EPS	393	530	779	833	968
BPS	3,750	4,230	4,959	5,639	6,556
DPS	50	50	50	50	50
SPS	4,567	6,379	6,750	7,427	8,342
Growth (%)					
Sales growth	9.2	39.9	5.9	11.8	13.0
OP growth	(5.1)	33.0	37.3	3.6	16.0
NP growth	3.1	35.0	47.0	8.7	16.8
EPS growth	3.1	34.9	47.0	7.0	16.1
EBITDA growth	(4.0)	26.0	32.2	4.2	17.5
Profitability (%)					
OP margin	10.7	10.2	13.2	12.3	12.6
NP margin	8.6	8.3	11.5	11.2	11.6
EBITDA margin	12.7	11.5	14.3	13.4	13.9
ROA	9.5	11.4	14.4	13.1	12.8
ROE	10.9	13.3	17.0	15.8	15.9
Dividend yield	1.1	2.1	1.1	1.3	1.3
Stability					
Net debt (W bn)	(2)	(2)	(5)	(5)	(6)
Int. coverage (x)	53.5	360.8	NM	NM	NM
D/E ratio (%)	1.0	0.0	0.1	0.2	0.2
Valuation (x)					
PER	11.5	4.4	5.6	4.8	4.2
PBR	1.2	0.6	0.9	0.7	0.6
PSR	1.0	0.4	0.7	0.5	0.5
EV/EBITDA	7.1	2.4	3.2	2.9	2.3

Changes to recommendation and price target

Company (Code)	Date	Recommendation	Price target	Company (Code)	Date	Recommendation	Price target
LG H&H (051900)	06-19-09	NA	NA	AmorePacific (090430)	08-01-08	BUY	W682,000
	11-18-09	BUY	W330,000		06-19-09	NM	W0
	01-27-10	BUY	W350,000		11-18-09	BUY	W1,055,000
	07-22-10	BUY	W422,000		07-22-10	BUY	W1,160,000
Able C&C (078520)	07-22-10	NM	NM	Kolmar Korea (024720)	07-22-10	NM	NM
Cosmax (044820)	07-22-10	NM	NM	Bioland (052260)	07-22-10	NM	NM
Daebong LS (078140)	07-22-10	NM	NM				

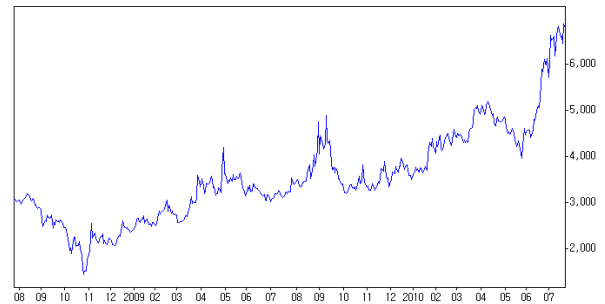
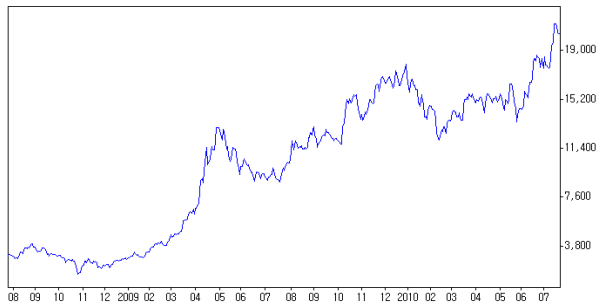
LG Household & Health Care (051900)

AmorePacific (090430)



Able C&C (078520)

Kolmar Korea (024720)

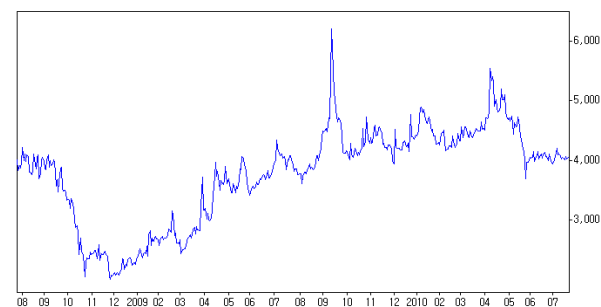


Cosmax (044820)

Bioland (052260)



Daebong LS (078140)



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

- BUY: Expected to outperform the market by 15%p or more.
- Hold: Expected to either outperform or underperform the market by less than 15%p.
- Underweight: Expected to underperform the market by 15%p or more.

■ **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.

■ **Analyst Certification**

I/We, as the research analyst/analysts who prepared this report, do hereby certify that the views expressed in this research report accurately reflect my/our personal views about the subject securities and issuers discussed in this report. I/We do hereby also certify that no part of my/our compensation was, is, or will be directly or indirectly related to the specific recommendations or views contained in this research report.

■ **Important Disclosures**

As of the end of the month immediately preceding the date of publication of the research report or the public appearance (or the end of the second most recent month if the publication date is less than 10 calendar days after the end of the most recent month), Korea Investment & Securities Co., Ltd., or its affiliates does not own 1% or more of any class of common equity securities of the companies mentioned in this report.

There is no actual, material conflict of interest of the research analyst or Korea Investment & Securities Co., Ltd., or its affiliates known at the time of publication of the research report or at the time of the public appearance.

Korea Investment & Securities Co., Ltd., or its affiliates has not managed or co-managed a public offering of securities for the companies mentioned in this report in the past 12 months;

Korea Investment & Securities Co., Ltd., or its affiliates has not received compensation for investment banking services from the companies mentioned in this report in the past 12 months; Korea Investment & Securities Co., Ltd., or its affiliates does not expect to receive or intends to seek compensation for investment banking services from the companies mentioned in this report in the next 3 months.

Korea Investment & Securities Co., Ltd., or its affiliates was not making a market in securities of the companies mentioned in this report at the time that the research report was published.

Korea Investment & Securities Co., Ltd. does not own over 1% of companies above mentioned shares as of July 21, 2010.

Korea Investment & Securities Co., Ltd. has not provided this report to various third parties.

Neither the analysts covering these companies nor their associates own any shares of as of July 21, 2010.

Prepared by: Jung-In Lee, Han Ji-hyung, Youngjoo Huh, Minha Choi

This report was written by Korea Investment & Securities Co., Ltd. to help its clients invest in securities. This material is copyrighted and may not be copied, redistributed, forwarded or altered in any way without the consent of Korea Investment & Securities Co., Ltd. This report has been prepared by Korea Investment & Securities Co., Ltd. and is provided for information purposes only. Under no circumstances is it to be used or considered as an offer to sell, or a solicitation of any offer to buy. We make no representation as to its accuracy or completeness and it should not be relied upon as such. The company accepts no liability whatsoever for any direct or consequential loss arising from any use of this report or its contents. The final investment decision is based on the client's judgment, and this report cannot be used as evidence in any legal dispute related to investment decisions.

HEAD OFFICE

WON-JAE RHEE, Executive Managing Director (wonjae@truefriend.com +822 3276 5660)
PAUL CHUNG, Sales Trading (pchung@truefriend.com +822 3276 5843)
27-1 Yoido-dong, Youngdeungpo-ku, Seoul 150-745, Korea
Toll free: US 1 866 258 2552 HK 800 964 464 SG 800 8211 320
Fax: 822 3276 5681~3
Telex: K22966

NEW YORK

DONG KIM, Managing Director (dkim@kisamerica.com +1 201 592 0631)
ELAINE AN, Head of Sales (Elaine@kisamerica.com +1 201 592 9161)
JU KIM, Sales (jukim@kisamerica.com +1 201 592 6473)
Korea Investment & Securities America, Inc.
400 Kelby Street, 11th Floor
Fort Lee, NJ 07024 USA
Fax: 1 201 592 1409

HONG KONG

STEVE KIM, Managing Director (steve.kim@kisasia.com +852 2530 8900)
SANGME LEE, Managing Director, Head of Asia Sales (sangme.lee@kisasia.com +852 2530 8910)
JEONGHEE LEE, Sales (jeonghee@kisasia.com +852 2530 8912)
DAN SONG, Sales (dan.song@kisasia.com, +852-2530-8900)
Korea Investment & Securities Asia, Ltd.
Room Suite 2110 Jardine House
1 Connaught Place, Central, Hong Kong
Fax: 852-2530-1516

SINGAPORE

SUNG NAMGOONG, Managing Director (snamgoong@truefriend.com +65 6501 5601)
TERRY SHIN, Sales (terryshin@truefriend.com +65 6501 5602)
Korea Investment & Securities Singapore Pte Ltd
1 Raffles Place, #43-04, OUB Center
048616 Singapore
Fax: 65 6501 5617

LONDON

JJ MOON, Managing Director (jamesmoon@kiseurope.com +44 207 065 2765)
BRANDON JUNE, Sales (brandonjune@kiseurope.com +44 207 065 2767)
Korea Investment & Securities Europe, Ltd.
2nd Floor, 35 Moorgate
London EC2R 6AR
Fax: 44-207-236-4811
Telex: 8812237

This report has been prepared by Korea Investment & Securities Co., Ltd. and is provided for information purposes only. Under no circumstances is it to be used or considered as an offer to sell, or a solicitation of any offer to buy. While all reasonable care has been taken to ensure that the information contained herein is not untrue or misleading at the time of publication, we make no representation as to its accuracy or completeness and it should not be relied upon as such. This report is provided solely for the information of professional investors who are expected to make their own investment decisions without undue reliance on this report and the company accepts no liability whatsoever for any direct or consequential loss arising from any use of this report or its contents. This report is not intended for the use of private investors.

2010. All rights reserved. No part of this report may be reproduced or distributed in any manner without permission of Korea Investment & Securities Co., Ltd.