

Duty-free shops

Overweight

Company	Rating	TP (KRW)
Hotel Shilla	BUY	53,000
Hana Tour Service	BUY	103,000
Hanwha Galleria Timeworld	Hold	-

DFS market review: Tougher environment

Incheon T2 DFS bid results announced

On April 29, the Korea Customs Service (KCS) announced the bid winners to operate duty-free shops (DFS) at the new passenger Terminal 2 (T2) at Incheon International Airport. Due to open in October, T2 has 10,208m² on the third floor of the departure lounge set aside for six DFS, of which three (DF1-DF3) were allocated to large companies and three (DF4-DF6) went to SMEs. Except for DF3, five slots were assigned operators. The DFS license bid followed the procedures set at the government's coordination meeting joined by the Ministry of Strategy and Finance, the Ministry of Land, Transport & Infrastructure, the KCS and the Incheon International Airport Corp. (IIAC) in February. In accordance with the new procedures, the IIAC recommended no. 1 and no. 2 operators for each slot after the business proposals (60%) and rent (40%) were reviewed by the DFS License Review Committee under the KCS for final selection. Unlike the third license bid for Terminal 1 held in 2015, companies were allowed to tender multiple bids for various slots but could not win more than one final allocation. For the DF1-DF3 slots set aside for large corporations, Hotel Shilla and Hotel Lotte were designated to run DF1 (perfume/cosmetics) and DF2 (liquor, tobacco and packaged food), respectively. For DF4-DF6 designated for SMEs, SM Duty Free, Entas Duty Free and Cityplus have been licensed to run DF4 (all items), DF5 (all items) and DF6 (fashion, miscellaneous goods and food), respectively (Table 2). The official licenses will be granted to the selected operators after the preparation period and are valid for five years.

Tougher operating environment

1) With a growing number of players, competition is intensifying in the DFS retail segment. Following the addition of four sites in December 2016 (three corporates and one SME), there are 13 in-city DFS venues in Seoul run by 10 operators. The number of venues has doubled since 2014 (six run by four operators). 2) While competition is getting fiercer, sales are eroding as Chinese tourists that account for more than 60% of in-city DFS sales have plummeted since mid-March on the escalation of political conflict between Korea and China. In March, Chinese arrivals plunged 40% YoY. Given the fewer passengers carried by Chinese airlines since March 10, the reduction in Chinese inbound traffic during April-May will likely be steeper. The Korea Tourism Organization (KTO) stated that Chinese tourists plunged 63.6% YoY during March 16 to April 9. While Chinese traveling abroad would climb during China's Labor Day holidays (Apr 29-May1), Korea was not among the top preferred tourism destinations and tourist arrivals should also retreat in April and May. 3) The KCS has agreed to extend the period by which in-city DFS operators that obtained business licenses at end-2016 must begin operations (previously by end-December 2017) due to mounting uncertainty stemming from fewer Chinese inbound tourists. 4) IIA DFS is also calling to reduce rent due to hard-hit sales with the decline of international tourists. The airport DFS delivers relatively weaker profitability due to the heavy rent burden, and if sales continue to trend down, it would be hard to shoulder the fixed costs.

Minha Choi

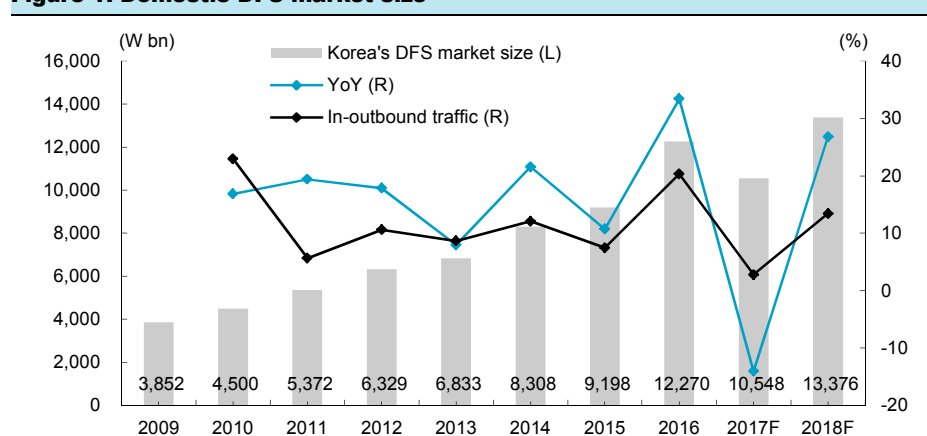
822-3276-6158

mhchoi@truefriend.com

DFS market's poor earnings to touch trough's bottom in 2Q17

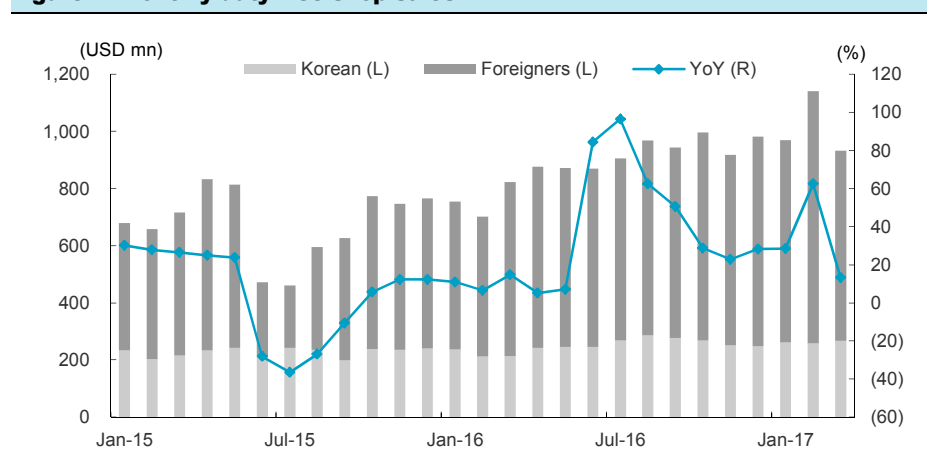
Outbound travelers are on the rise but this is insufficient to offset the drop in Chinese visitors that contribute so much to DFS sales. While domestic DFS sales increased 28.5% YoY in January 2017 and jumped 62.4% YoY in February, the figure grew only 13% YoY in March when inbound traffic turned to a decline (Figure 2). With the DFS market's top-line erosion set to accelerate in 2Q17, poor earnings at DFS operators will probably reach their worst. We estimate the 2017 domestic DFS market size at W10.5tn, down 14% YoY. Given the current mix of uncertainties, a conservative approach is recommended. When signals for a market upturn are detected including Chinese tourist trends, DFS operators would be able to make a meaningful turnaround.

Figure 1. Domestic DFS market size

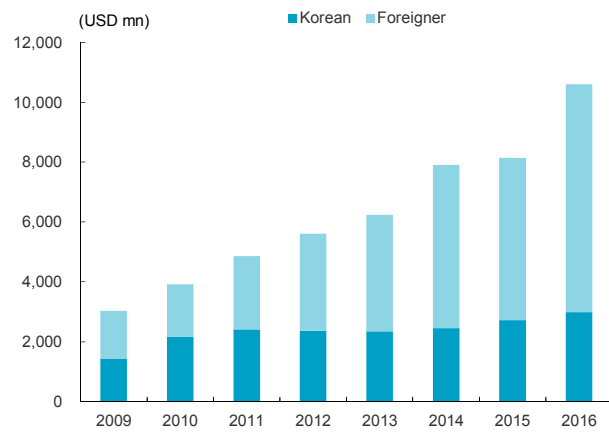


Source: Korea Customs Service, Korea Tourism Organization, Korea Investment and Securities

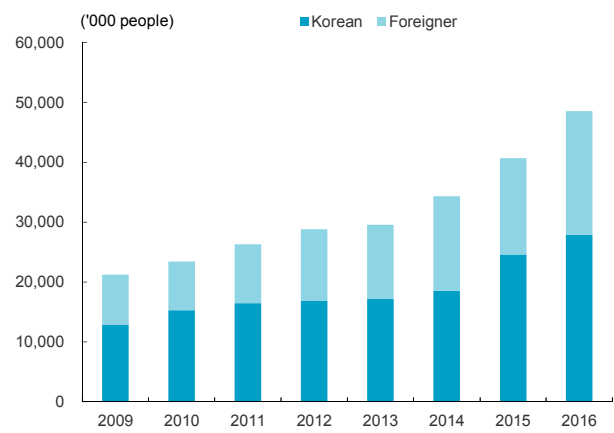
Figure 2. Monthly duty-free shop sales



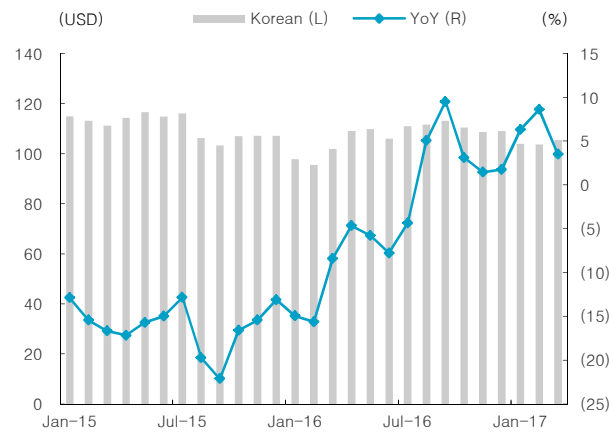
Source: Korea Duty Free Shops Association, Korea Investment and Securities

Figure 3. Duty-free shop sales by nationality


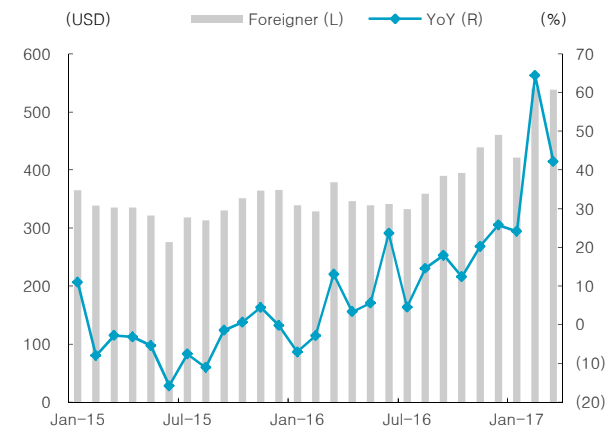
Source: Korea Duty Free Shops Association, Korea Investment and Securities

Figure 4. No. of duty-free shop visitors by nationality


Source: Korea Duty Free Shops Association, Korea Investment and Securities

Figure 5. ASP for domestic DFS (Korean)


Source: Korea Duty Free Shops Association, Korea Investment and Securities

Figure 6. ASP for domestic DFS (foreigner)


Source: Korea Duty Free Shops Association, Korea Investment and Securities

Table 1. Downtown duty free shops in Korea

City	No.	Operator	Shop	Business start	Location	Size
Seoul	1	Hotel Lotte	Lotte Duty Free Main	1980	Sogong-dong, Jung-gu	13,236 m ²
	2	Hotel Lotte	Lotte Duty Free COEX	2000	Samseong-dong, Gangnam-gu	5,828 m ²
	3	Hotel Shilla	The Shilla Duty Free Seoul	1986	Dongho-ro, Jung-gu	7,270 m ²
	4	Dongwha Duty Free	Dongwha Duty Free	1973	Sejongdae-ro, Jongro-gu	6,460 m ²
(Newly granted)	5	HDC Shilla Duty Free	Shilla iPark Duty Free	Dec-15	I'Park Mall, Yongsan-gu	27,400 m ²
	6	HGT	Galleria Duty Free Seoul	Dec-15	63 Building, Yeouido, Youngdeungpo-gu	10,072 m ²
	7	SM Duty Free	SM Duty Free Seoul	Jan-16	Insa-dong, Jongno-gu	9,977 m ²
(Newly granted 2)	8	Shinsegae DF	Shinsegae Duty Free	May-16	Main branch of Shinsegae Department store, Chungmuro, Jung-gu	13,884 m ²
	9	Doosan Corp	Doota Duty Free	May-16	Doosan Tower, Dongdaemun Jung-gu	16,825 m ²
(Newly granted 3)	10	Hotel Lotte	Lotte DFS World Tower	1989/ Jan-2017	Songpa-gu Shincheon dong	17,334 m ²
	11	Shinsegae DF	Central City DFS (Tentative name)	Expected 2017 (Delayed)	Secho-gu Central City	13,350 m ²
	12	Hyundai Dept. Store Duty Free	Trade Center DFS (Tentative name)	Expected 2017 (Delayed)	Samseong-dong Trade Center	14,005 m ²
	13	Top City Duty Free (City Plus)	Top City Duty Free (Tentative name)	Expected 2017 (Delayed)	Sinchon-dong Minja station	-
Busan	1	Hotel Lotte	Lotte Duty Free Busan	1995	Bujeon-dong, Busanjin-gu	5,600 m ²
	2	Shinsegae Chosun Hotel	Shinsegae Duty Free Busan	2009	Jung-dong, Haeundae-gu	8,600 m ²
(Newly granted)	3	Busan Duty Free	Busan Duty Free	Expected 2017 (Delayed)	Jung-gu Yongdusan park	-
Jeju	1	Lotte Duty Free Jeju	Lotte Duty Free Jeju	2000	Yeon-dong	6,612 m ²
	2	Hotel Shilla	The Shilla Duty Free Jeju	1989	Noyeon-ro	6,765 m ²
(Newly granted)	3	JTO	JTO Duty Free	Feb-16	Jungmun Resort, Seogwipo-si	2,634 m ²
Incheon	1	Entas Duty Free	Incheon Entas Duty Free	2015	Guwol-dong, Nangdong-gu	4,300 m ²
Ulsan	1	Jinsan Marine Management	Ulsan Jinsan Duty Free	2013	Jung-gu	1,296 m ²
Changwon	1	Daedong Department Store	Daedong Duty Free	2013	Euichang-gu	930 m ²
Daejeon	1	Shinwoo Industries	Shinwoo Duty Free	2013	Oncheon-ro, Useong-gu	852 m ²
Daegu	1	Grand Hotel	Grand Duty Free Daegu	2013	Beomeo-dong, Suseong-gu	1,224 m ²
Chungnam	1	DF Korea	DF Korea Duty Free	2016	-	-
Suwon	1	Hotel Encore	Encore Duty Free	2013	Paldal-gu	1,646 m ²
Cheongju	1	Jungwon Industrial	Jungwon Duty Free	2013	Ramada Hotel, Cheongwon-gu	1,030 m ²
Gangwon	1	Alpensia	Alpensia Duty Free	Expected 2017 (Delayed)	Alpensia Resort Pyeongchang	-

Note: 1. For Hotel Lotte COEX branch, the business start is based on the business start of AK Duty Free; Date of acquisition is July 2010

2. Lotte DFS World Tower lost its business license in Nov 2015, but regained its right in Dec 2016 and reopened in Jan 2017

3. (Newly granted) – business granted in Jul 2015 / (Newly Granted 2) – business granted in Nov 2015 / (Newly granted 3) – business granted in Dec 2016

Source: Company data, Korea Investment and Securities

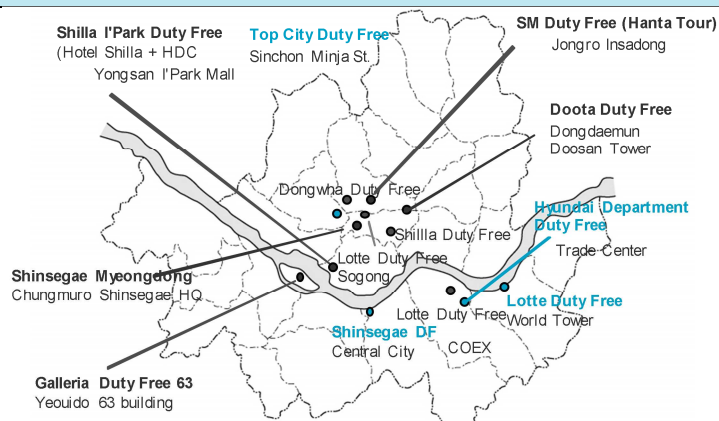
Table 2. Results for Incheon International Airport's Terminal 2 DFS bids

(W bn, m², stores)

Type of company	Slots	Winner	Product categories	Minimum bid price	Floor area	No. of stores	Location
Conglomerate	DF1	Hotel Shilla	Fragrance/cosmetics	84.7	2,105	6	Third floor Terminal 2 east/west boarding area
	DF2	Hotel Lotte	Liquor/tobacco/foods	55.4	1,407	8	Third floor Terminal 2 east/west boarding area
	DF3	-	Fashion/sundries	64.7 / 58.2	4,889	14	Third floor Terminal 2 central/east/west boarding area
SME	DF4	SM Duty Free	All	8.8	825	2	Third floor Terminal 2 east boarding area
	DF5	Entas	All	6.6	741	1	Third floor Terminal 2 west boarding area
	DF6	Cityplus	Fashion/sundries/foods	2.1	241	2	Third floor Terminal 2 west boarding area
Total				222.4	10,208	33	

Note: Minimum bid price for DF3 slot is based on current/second tender price as it failed to receive any bids from duty-free operators in the first tender

Source: Korea Customs Service, Korea Investment and Securities

Figure 7. Downtown DFS locations in Seoul

Note: Newly selected DFS locations on December 17 are in blue, those selected in July and November 2015 are in bold type
Source: Korea Investment and Securities

Table 3. Coverage valuation

Recommendation & TP			Earnings & Valuation										
Company				Sales	OP	NP	EPS	BPS	PE	PB	ROE	EV/EBITDA	DY
				(W bn)	(W bn)	(W bn)	(KRW)	(KRW)	(X)	(X)	(%)	(X)	(%)
Hotel Shilla (008770)	Recommendation	BUY	2015A	3,252	77	18	469	18,697	164.8	4.1	2.5	23.8	0.5
	TP (KRW)	53,000	2016A	3,715	79	28	729	19,150	66.0	2.5	4.0	14.4	0.7
	Price (Apr 28, KRW)	50,800	2017F	3,688	59	34	899	19,914	56.5	2.6	5.0	17.2	0.4
	Market cap. (W bn)	1,993	2018F	4,121	127	81	2,135	21,658	23.8	2.3	11.1	11.4	0.8
			2019F	4,634	171	114	3,026	24,196	16.8	2.1	14.1	9.2	0.9
Hana Tour Service (039130)	Recommendation	BUY	2015A	459	45	32	2,877	20,021	40.0	5.7	16.8	20.7	1.3
	TP (KRW)	103,000	2016A	596	21	8	727	19,237	90.9	3.4	4.2	15.4	2.3
	Price (Apr 28, KRW)	84,400	2017F	654	49	38	3,398	21,086	24.8	4.0	18.8	8.6	1.8
	Market cap. (W bn)	980	2018F	707	66	51	4,633	24,016	18.2	3.5	22.5	6.4	1.9
			2019F	756	78	60	5,451	27,726	15.5	3.0	22.6	5.1	1.9
Hanwha	Recommendation	Hold	2015A	169	16	9	1,444	47,002	68.2	2.1	3.0	25.4	1.0
Galleria	TP (KRW)	-	2016A	285	(12)	(19)	(3,163)	41,283	NM	0.8	(7.1)	61.7	0.0
Timeworld	Price (Apr 28, KRW)	34,250	2017F	354	(2)	(5)	(915)	38,756	(37.4)	0.9	(2.3)	18.3	0.0
(027390)	Market cap. (W bn)	205	2018F	436	15	7	1,191	37,317	28.7	0.9	3.1	8.4	2.9
			2019F	546	37	22	3,785	38,428	9.0	0.9	9.9	3.9	2.9

Source : Company data, Korea Investment and Securities

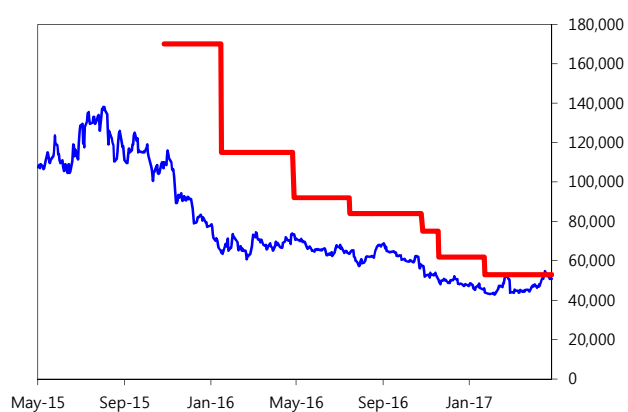
Glossary

- Duty-free shops (DFS): Sells goods to domestic outbound travelers that are exempt from taxes including duties and sales taxes (i.e., value-added tax, individuals sales tax, liquor and tobacco taxes); A DFS must first obtain a license from the Korea Customs Service; Thus in Korea, a duty-free store is run by a licensed operator
- Tax refund store: Sells goods to foreign tourists and provides the necessary declaration form and receipts to claim a tax refund; Foreign visitors who purchase goods worth W30,000 (tax incl.) or more at a registered store may claim a refund at airport kiosks for the value-added tax (10%) and individual sales tax (5-20%) paid in their purchases; Tax refunds must be claimed within three months; A tax refund store does not require a license and may begin business after registering with the tax office of its jurisdiction

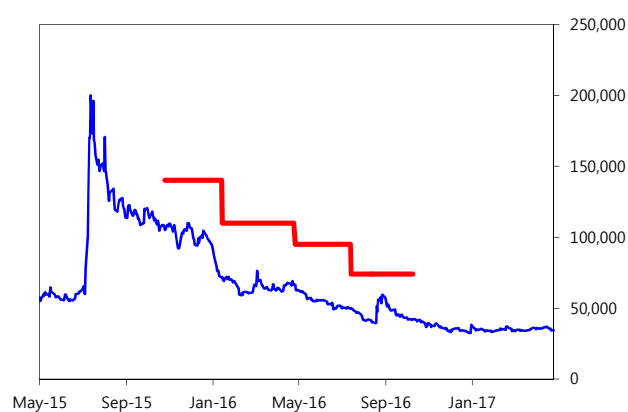
Changes to recommendation and price target

Company (Code)	Date	Recommendation	Price target	Company (Code)	Date	Recommendation	Price target
Hotel Shilla (008770)	10-30-15	BUY	W170,000	Hana Tour Service (039130)	10-17-16	Hold	-
	01-19-16	BUY	W115,000		05-07-15	BUY	W162,000
	05-01-16	BUY	W92,000		07-13-15	BUY	W185,000
	07-19-16	BUY	W84,000		08-04-15	BUY	W220,000
	10-30-16	BUY	W75,000		12-14-15	BUY	W165,000
	11-22-16	BUY	W62,000		02-02-16	BUY	W145,000
	01-26-17	BUY	W53,000		04-22-16	BUY	W120,000
Hanwha Galleria Timeworld (027390)	10-30-15	BUY	W140,000		07-19-16	BUY	W97,000
	01-19-16	BUY	W110,000		11-02-16	BUY	W86,000
	05-01-16	BUY	W95,000		04-04-17	BUY	W103,000
	07-19-16	BUY	W74,000				

Hotel Shilla(008770)



Hanwha Galleria Timeworld(027390)



Hana Tour Service(039130)



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

- BUY: Expected to outperform the market index by 15%p or more
- Hold: Expected to underperform or outperform the market index by less than 15%p
- Underweight: Expected to underperform the market index by 15%p or more
- Korea Investment & Securities does not offer target prices for stocks with Hold or Underweight ratings.

■ **Guide to Korea Investment & Securities Co., Ltd. stock rating allocation (as of Mar 31, 2017)**

BUY	Hold	Underweight (Sell)
77.4%	21.7%	0.9%

Note: % of companies under coverage with this rating

■ **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 compliance notice**

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 intend 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. owns over 1% of shares of the companies mentioned in this report as of May 2, 2017.

Korea Investment & Securities Co., Ltd. does not own over 1% of shares of the companies mentioned in this report as of May 2, 2017.

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

Neither the analyst/analysts who prepared this report nor their associates own any shares of the company/companies mentioned in this report as of May 2, 2017.

Korea Investment & Securities Co., Ltd. has issued ELW with underlying stocks of Hotel Shilla and is the liquidity provider.

Prepared by: Minha Choi

Global Disclaimer

■ General

This research report and marketing materials for Korean securities are originally prepared and issued by the Research Center of Korea Investment & Securities Co., Ltd., an organization licensed with the Financial Supervisory Service of South Korea. The analyst(s) who participated in preparing and issuing this research report and marketing materials is/are licensed and regulated by the Korea Financial Investment Association in Korea only. This report and marketing materials are copyrighted and may not be copied, redistributed, forwarded or altered in any way without the consent of Korea Investment & Securities Co., Ltd.

This research report and marketing materials are for information purposes only. They are not and should not be construed as an offer or solicitation of an offer to purchase or sell any securities or other financial instruments or to participate in any trading strategy. This research report and marketing materials do not provide individually tailored investment advice. This research report and marketing materials do not take into account individual investor circumstances, objectives or needs, and are not intended as recommendations of particular securities, financial instruments or strategies to any particular investor. The securities and other financial instruments discussed in this research report and marketing materials may not be suitable for all investors. The recipient of this research report and marketing materials must make their own independent decisions regarding any securities or financial instruments mentioned herein and investors should seek the advice of a financial adviser. Korea Investment & Securities Co., Ltd. does not undertake that investors will obtain any profits, nor will it share with investors any investment profits. Korea Investment & Securities Co., Ltd., its affiliates, or their affiliates and directors, officers, employees or agents of each of them disclaim any and all responsibility or liability whatsoever for any loss (director consequential) or damage arising out of the use of all or any part of this report or its contents or otherwise arising in connection therewith. Information and opinions contained herein are subject to change without notice and may differ or be contrary to opinions expressed by other business areas or Korea Investment & Securities Co., Ltd. The final investment decision is based on the client's judgment, and this research report and marketing materials cannot be used as evidence in any legal dispute related to investment decisions.

■ Country-specific disclaimer

United States: This report is distributed in the U.S. by Korea Investment & Securities America, Inc., a member of FINRA/SIPC, and is only intended for major U.S. institutional investors as defined in Rule 15a-6(a)(2) under the U.S. Securities Exchange Act of 1934. All U.S. persons that receive this document by their acceptance thereof represent and warrant that they are a major U.S. institutional investor and have not received this report under any express or implied understanding that they will direct commission income to Korea Investment & Securities, Co., Ltd. or its affiliates. Pursuant to Rule 15a-6(a)(3), any U.S. recipient of this document wishing to effect a transaction in any securities discussed herein should contact and place orders with Korea Investment & Securities America, Inc., which accepts responsibility for the contents of this report in the U.S. The securities described in this report may not have been registered under the U.S. Securities Act of 1933, as amended, and, in such case, may not be offered or sold in the U.S. or to U.S. person absent registration or an applicable exemption from the registration requirement.

United Kingdom: This report is not an invitation nor is it intended to be an inducement to engage in investment activity for the purpose of section 21 of the Financial Services and Markets Act 2000 of the United Kingdom ("FSMA"). To the extent that this report does constitute such an invitation or inducement, it is directed only at (i) persons who are investment professionals within the meaning of Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (as amended) of the United Kingdom (the "Financial Promotion Order"); (ii) persons who fall within Articles 49(2)(a) to (d) ("high net worth companies, unincorporated associations etc.") of the Financial Promotion Order; and (iii) any other persons to whom this report can, for the purposes of section 21 of FSMA, otherwise lawfully be made (all such persons together being referred to as "relevant persons"). Any investment or investment activity to which this report relates is available only to relevant persons and will be engaged in only with relevant persons. Persons who are not relevant persons must not act or rely on this report.

Hong Kong: This research report and marketing materials may be distributed in Hong Kong to institutional clients by Korea Investment & Securities Asia Limited (KISA), a Hong Kong representative subsidiary of Korea Investment & Securities Co., Ltd., and may not otherwise be distributed to any other party. KISA provides equity sales service to institutional clients in Hong Kong for Korean securities under its sole discretion, and is thus solely responsible for provision of the aforementioned equity selling activities in Hong Kong. All requests by and correspondence with Hong Kong investors involving securities discussed in this report and marketing materials must be effected through KISA, which is registered with The Securities & Futures Commission (SFC) of Hong Kong. Korea Investment & Securities Co., Ltd. is not a registered financial institution under Hong Kong's SFC.

Singapore: This report is provided pursuant to the financial advisory licensing exemption under Regulation 27(1)(e) of the Financial Advisers Regulation of Singapore and accordingly may only be provided to persons in Singapore who are "institutional investors" as defined in Section 4A of the Securities and Futures Act, Chapter 289 of Singapore. This report is intended only for the person to whom Korea Investment & Securities Co., Ltd. has provided this report and such person may not send, forward or transmit in any way this report or any copy of this report to any other person. Please contact Korea Investment & Securities Singapore Pte Ltd in respect of any matters arising from, or in connection with, the analysis or report (Contact Number: 65 6501 5600).

Copyright © 2017 Korea Investment & Securities Co., Ltd. All rights reserved. No part of this report may be reproduced or distributed in any manner without permission of Korea Investment & Securities Co., Ltd.