

Hotel Shilla (008770)

12M rating **Hold (Downgrade)**

Margin improvements to be slow

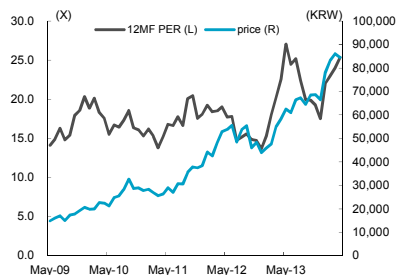
Stock Data

KOSPI (Apr 14, pt)	1,997
Stock price (Apr 14, KRW)	84,500
Market cap (USD mn)	3,192
Shares outstanding (mn)	39
52-Week high/low (KRW)	91,400/54,200
6M avg. daily turnover (USD mn)	21.1
Free float / Foreign ownership (%)	81.5/39.5
Major shareholders (%)	
Samsung Life Insurance Co., Ltd and 4 others	16.9
National Pension Service (NPS)	10.0

Performance

	1M	6M	12M
Absolute (%)	(2.2)	37.4	53.1
Relative to KOSPI (%p)	(6.2)	38.5	49.3

12MF PE trend



Source: WISEfn consensus

High valuation burden despite growth potential, downgrade to Hold

We downgrade Hotel Shilla to Hold. 1) While solid growth should continue on increasing Chinese tourism, margin upside should be limited on a lower KRW/USD and higher marketing spending. 2) Occupancy rates are normalizing slowly at the Seoul Hotel due to the weak JPY. 3) Earnings contribution from the perfume and cosmetics DFS at Singapore's Changi Airport, scheduled to launch in 4Q14, should be limited given heavy capital investments and early marketing costs. 4) Rent at Incheon International Airport (IIA) is expected to increase from 2015 after renegotiations. 5) Despite the earnings recovery in 2014 and overseas DFS sales from 2015, valuations are still high at 30.7x 12MF PE.

1Q14 OP to miss consensus

We estimate 1Q14 consolidated sales at W608.7bn, up 27.4% YoY and 5.3% higher than consensus (W578.2bn), and OP at W25.5bn, up 246.2% YoY but 14.0% lower than consensus (W29.7bn). DFS sales should grow 22.4% YoY to W540.5bn, with Chinese DFS sales surging 61.4% YoY on a 42.6% YoY increase in Chinese tourism in 1Q14. However, Japanese DFS sales should fall 26% YoY on less visitors and eroding purchasing power due to the weak JPY. Domestic DFS sales should grow 10% YoY on increased outbound travel. Meanwhile, hotel sales should grow 124.5% YoY (low base effect given renovations in 1H13), but still generate an W8.2bn operating loss as occupancy rates remain low due to the weak JPY. 1Q14 DFS OPM is expected to firm 3.7%p QoQ to 5.7% as the KRW/USD rate stabilizing and one-off costs from 4Q13 (special Samsung group bonus) do not recur.

Recent KRW strength to erode 2Q14 results

Compared to the 1Q14 average of W1,069.2, the KRW/USD rate fell another 2.92% to W1,038.9 on April 13. And, FX rate changes have two major effects on earnings. A strong KRW reduces foreign visitors, especially from Japan, and undermines KRW-based sales while lifting costs. DFS sales are fully settled in USD, so KRW-based sales decline on a lower KRW/USD rate. And, COGS increases as merchandise was procured at higher KRW/USD rates. Most operating costs, excluding product purchasing fees, are paid on a KRW basis, so a lower KRW/USD rate also erodes OPM (Figure 3).

Yr to	Sales	OP	EBT	NP	EPS	% chg	EBITDA	PE	EV/EBITDA	PB	ROE
Dec	(W bn)	(W bn)	(W bn)	(W bn)	(won)	(YoY)	(W bn)	(x)	(x)	(x)	(%)
2012A	2,220	129	133	101	2,566	79.9	174	17.1	11.1	2.5	15.6
2013A	2,297	87	16	11	274	(89.3)	138	242.7	21.6	3.9	1.6
2014F	2,824	146	128	97	2,461	798.3	215	34.3	17.1	4.4	13.4
2015F	3,584	199	179	136	3,452	40.3	268	24.5	14.0	3.7	16.3
2016F	3,882	249	230	174	4,431	28.4	320	19.1	11.4	3.2	17.7

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

Jonggil Hong

822-3276-6168

jonggil@truefriend.com

Rent increases more important than contract extensions for IIA DFS

On April 14, Money Today reported IIA was considering extending DFS contracts by another three years. Specifically, IIA is reviewing plans to extend current DFS licenses until February 2018, when the second terminal is scheduled to open. Given the expected changes to the business environment from the new terminal, the Ministry of Land, Infrastructure and Transportation plans to maintain DFS license holders until 2018.

Hotel Shilla has operated DFS at IIA since March 2008, and recently extended its contract from March 2013 to February 2015. Previously, the market expected a third contract period would be determined by bids in 1H14. Despite the renegotiations, we expect Hotel Shilla is likely to win another DFS license as there are few domestic competitors that can pay the high rent costs and as Hotel Shilla has developed a solid relationship with IIA. Going forward, we expect rents to increase in line with the uptick in airport travelers (10% in 2015, 5% in 2016), after being frozen since March 2013. We believe enterprise value will improve further if rent hikes are less than our expectations, as licenses are renewed without renegotiations.

Table 1. Quarterly earnings and forecasts (Consolidated)

(W bn, %, %p)

	1Q13	4Q13	1Q14F	QoQ	YoY	Consensus	Difference	2Q14F	3Q14F	4Q14F
Sales	478.0	593.7	608.7	2.5%	27.4%	578.2	5.3%	672.9	792.8	749.2
Duty-free	441.6	524.8	540.5	3.0%	22.4%			594.1	706.3	666.4
Hotel	26.1	56.3	58.5	3.9%	124.5%			65.9	75.4	69.5
Life&Leisure	11.0	14.9	10.7	(28.1%)	(2.2%)			13.9	12.7	15.8
OP	7.4	5.8	25.5	340.1%	246.2%	29.7	(14.0%)	33.2	53.8	33.5
OPM	1.5%	1.0%	4.2%	3.2%p	2.7%p	5.1%	(0.9%p)	4.9%	6.8%	4.5%
Duty-free	12.5	10.6	31.0	192.2%	148.3%			29.3	48.0	28.8
Duty-free OPM	2.8%	2.0%	5.7%	3.7%p	2.9%p			4.9%	6.8%	4.3%
Hotel	(6.6)	(7.9)	(8.2)	3.9%	23.6%			1.0	3.1	1.9
Life&Leisure	1.6	3.1	2.9	(7.7%)	83.7%			3.0	2.9	3.0
EBT	(25.8)	(1.3)	21.3	-	-	29.9	-	29.2	49.6	27.7
NP	(20.1)	(1.5)	16.2	-	-	21.7	-	22.1	37.6	21.0

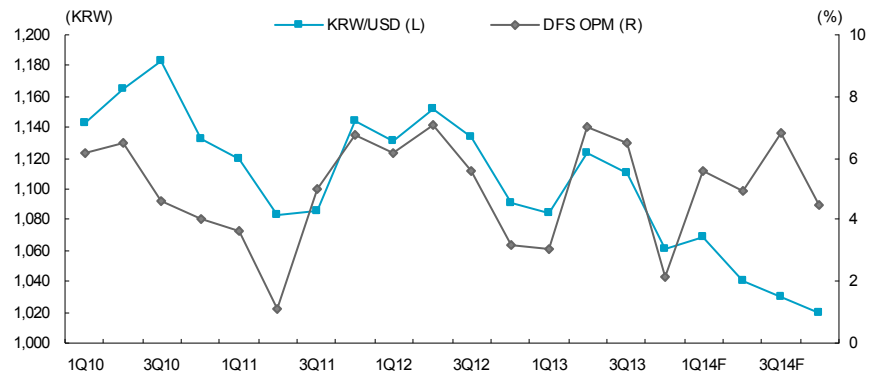
Source: Company data, Korea Investment & Securities

Table 2. Quarterly earnings and forecasts (Separate)

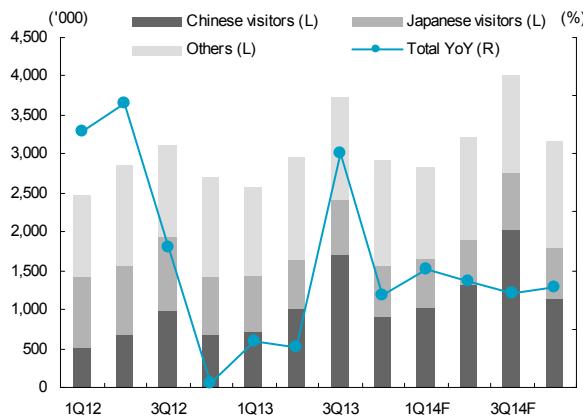
(W bn, %, %p)

	1Q13	4Q13P	1Q14F	QoQ	YoY	Consensus	Difference	2Q14F	3Q14F	4Q14F
Sales	473.4	587.5	600.1	2.1%	26.8%	573.0	4.7%	661.9	779.7	651.2
Duty-free	438.9	518.0	532.9	2.9%	21.4%			583.9	693.5	567.9
Hotel	26.1	56.2	58.5	4.1%	124.1%			65.9	75.4	69.5
Life&Leisure	8.4	13.3	8.7	(34.4%)	3.8%			12.1	10.9	13.8
OP	8.5	6.0	24.3	305.0%	185.2%	31.7	(23.3%)	32.9	53.1	30.5
OPM	1.8%	1.0%	4.0%	3.0%p	2.2%p	5.5%	(1.5%p)	5.0%	6.8%	4.7%
Duty-free	13.4	11.2	29.7	164.7%	121.3%			28.9	47.1	25.6
Duty-free OPM	3.1%	2.2%	5.6%	3.4%p	2.5%p			4.9%	6.8%	4.5%
Hotel	(6.6)	(8.0)	(8.2)	2.6%	24.4%			1.0	3.1	1.9
Life&Leisure	1.7	2.7	2.9	6.0%	66.3%			3.0	2.9	3.0
EBT	(24.9)	(1.0)	22.2	-	-	31.2	-	30.8	50.9	28.4
NP	(18.9)	(0.9)	16.8	-	-	23.5	-	23.3	38.6	21.5

Source: Company data, Korea Investment & Securities

Figure 1. KRW/USD rate vs duty-free OPM

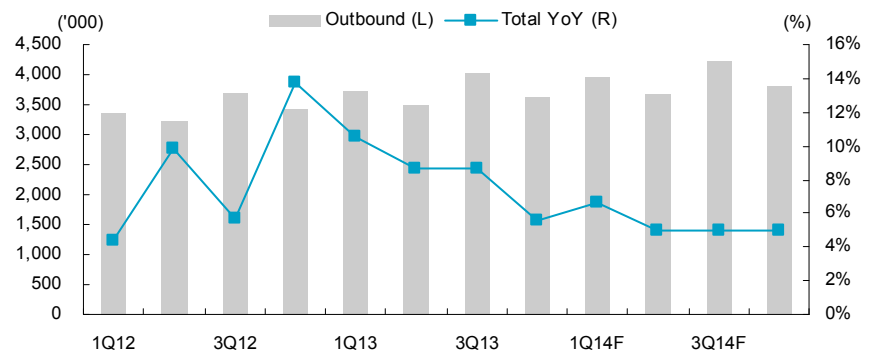
Note: Quarterly average KRW/USD exchange rate, Separate Duty-free OPM
Source: Company data, Korea Investment & Securities

Figure 2. Quarterly inbound traffic and forecast

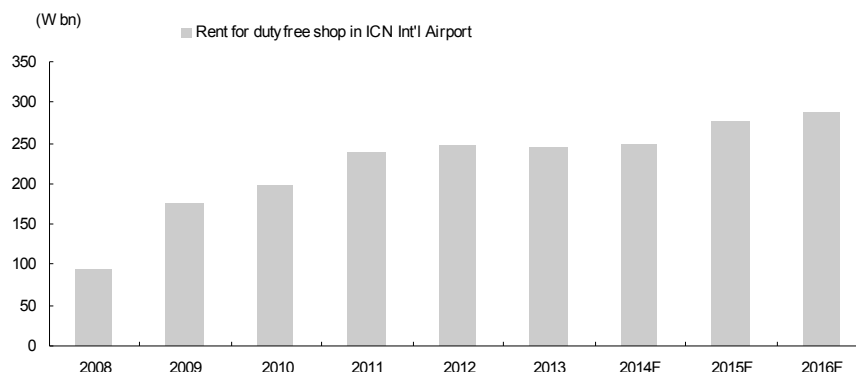
Source: The Korea Tourist Service, Korea Investment & Securities

Figure 3. Monthly Chinese visitors and YoY trend

Source: The Korea Tourist Service

Figure 4. Quarterly outbound traffic and forecast

Source: The Korea Tourist Service, Korea Investment & Securities

Figure 5. Rent for DFS in ICN Int'l Airport

Source: Company data, Korea Investment & Securities

Table 3. Annual earnings and forecast (Consolidated)

(W bn, %, %p)

	2012	2013	YoY	2014F	YoY	2015F	YoY
Sales	2,219.6	2,297.0	3.5%	2,823.7	22.9%	3,584.0	26.9%
Duty-free	1,901.8	2,086.5	9.7%	2,507.4	20.2%	3,242.0	29.3%
Hotel	255.3	165.1	(35.4%)	269.3	63.1%	294.6	9.4%
Life&Leisure	64.2	50.9	(20.7%)	53.1	4.3%	54.8	3.3%
OP	129.3	86.6	(33.0%)	146.1	68.7%	198.8	36.1%
OPM	5.8%	3.8%	(2.1%p)	5.2%	1.4%p	5.5%	0.4%p
Duty-free	103.6	96.3	(7.0%)	137.0	42.2%	183.2	33.7%
Duty-free OPM	5.4%	4.6%	(0.8%p)	5.5%	0.8%p	5.7%	0.2%p
Hotel	16.6	(21.4)	-	(2.3)	(89.3%)	2.6	-
Life&Leisure	9.1	11.7	28.1%	11.8	0.7%	13.4	13.8%
EBT	133.5	16.0	(88.0%)	127.8	697.8%	179.3	40.2%
NP	101.0	10.8	(89.3%)	96.9	796.3%	135.9	40.2%

Source: Company data, Korea Investment & Securities

Table 4. 2014-2015F earnings revision

(W bn, %, %p)

	2014F			2015F		
	Previous	Revised	%	Previous	Revised	%
Sales	2,775.5	2,823.7	1.7%	3,530.7	3,584.0	1.5%
Duty-free	2,439.7	2,507.4	2.8%	3,171.9	3,242.0	2.2%
Hotel	288.7	269.3	(6.7%)	311.5	294.6	(5.4%)
Life&Leisure	53.1	53.1	(0.0%)	54.8	54.8	(0.1%)
OP	203.5	146.1	(28.2%)	251.5	198.8	(20.9%)
OPM	7.3%	5.2%	(2.2%p)	7.1%	5.5%	(1.6%p)
EBT	188.8	127.8	(32.3%)	234.1	179.3	(23.4%)
NP	143.1	96.9	(32.3%)	177.5	135.9	(23.4%)

Source: Korea Investment & Securities

Company overview & Glossary

Hotel Shilla runs three businesses: duty-free shops, hotels and lifestyle & leisure. As of 2013, duty-free shops, hotels and life & leisure account for 91%, 7% and 2% of sales, respectively. The company started the duty-free business in 1986, and currently operates two downtown and four airport duty-free shops. The company owns and manages hotels in Seoul and Jeju, and commissioned management of two hotels. Lifestyle & leisure includes travel, fitness centers and restaurants.

- Duty-free shops: Retail outlets at airports or downtown, which are exempt from taxes and duties

Balance sheet

FY-ending Dec. (W bn)	2012A	2013A	2014F	2015F	2016F
Current assets	747	709	838	1,052	1,136
Cash & cash equivalent	274	226	254	305	330
Accounts & other receivables	95	106	130	165	179
Inventory	355	337	414	525	569
Non-current assets	801	1,003	1,055	1,216	1,280
Investment assets	292	336	349	484	524
Tangible assets	482	643	680	707	729
Intangible assets	26	23	25	25	27
Total assets	1,548	1,712	1,893	2,269	2,417
Current liabilities	348	433	488	683	643
Accounts & other payables	195	235	282	358	388
ST debt & bond	0	0	0	0	0
Current portion of LT debt	80	140	140	260	180
Non-current liabilities	510	601	636	686	706
Debentures	0	0	0	0	0
LT debt & financial liabilities	389	449	449	449	449
Total liabilities	858	1,034	1,123	1,369	1,349
Controlling interest	689	679	770	899	1,068
Capital stock	200	200	200	200	200
Capital surplus	197	197	197	197	197
Capital adjustments	(4)	(4)	(4)	(4)	(4)
Retained earnings	291	288	379	509	677
Minority interest	0	0	0	0	0
Shareholders' equity	689	679	770	899	1,068

Cash flow

FY-ending Dec. (W bn)	2012A	2013A	2014F	2015F	2016F
C/F from operating	145	153	155	168	246
Net profit	101	11	97	136	174
Depreciation	38	42	62	63	64
Amortization	6	9	7	7	7
Net incr. in W/C	(26)	55	(13)	(41)	(0)
Others	26	36	2	3	1
C/F from investing	(16)	(285)	(121)	(231)	(135)
CAPEX	(44)	(218)	(99)	(90)	(86)
Decr. in fixed assets	1	2	0	0	0
Incr. in investment	32	(63)	(13)	(135)	(40)
Net incr. in intangible assets	(6)	(6)	(9)	(6)	(9)
Others	1	0	0	0	0
C/F from financing	16	85	(6)	114	(86)
Incr. in equity	1	0	0	0	0
Incr. in debts	48	119	0	120	(80)
Dividends	(12)	(12)	(6)	(6)	(6)
Others	(21)	(22)	0	0	0
C/F from others	(0)	(0)	0	0	0
Increase in cash	144	(48)	28	51	25

Note: Based on K-IFRS (consolidated)

Income statement

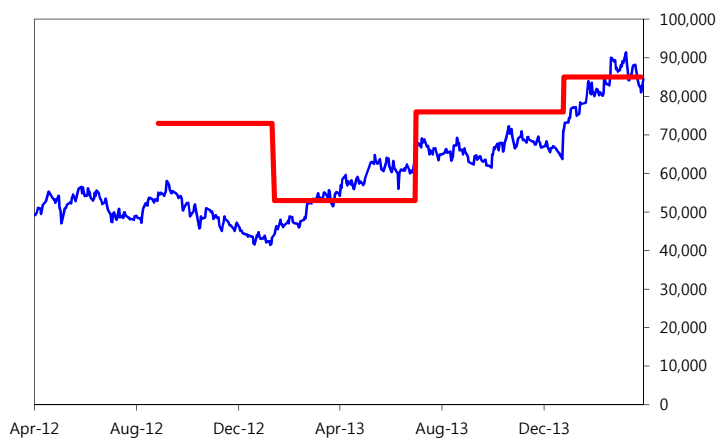
FY-ending Dec. (W bn)	2012A	2013A	2014F	2015F	2016F
Sales	2,220	2,297	2,824	3,584	3,882
COGS	1,247	1,327	1,607	1,969	2,131
Gross profit	973	970	1,217	1,615	1,750
SG&A expense	844	883	1,071	1,416	1,501
Operating profit	129	87	146	199	249
Financial income	16	20	16	17	17
Interest income	16	20	16	17	17
Financial expense	25	27	28	29	29
Interest expense	25	27	28	29	29
Other non-operating profit	14	(63)	(6)	(7)	(8)
Gains (Losses) in associates, subsidiaries and JV	0	0	0	0	0
Earnings before tax	133	16	128	179	230
Income taxes	32	5	31	43	56
Net profit	101	11	97	136	174
Net profit of controlling interest	101	11	97	136	174
Other comprehensive profit	(2)	(10)	0	0	0
Total comprehensive profit	99	1	97	136	174
Total comprehensive profit of controlling interest	99	1	97	136	174
EBITDA	174	138	215	268	320

Key financial data

FY-ending Dec.	2012A	2013A	2014F	2015F	2016F
per share data (KRW)					
EPS	2,566	274	2,461	3,452	4,431
BPS	17,328	17,062	19,336	22,585	26,796
DPS	300	150	150	150	150
Growth (%)					
Sales growth	23.4	3.5	22.9	26.9	8.3
OP growth	32.5	(33.0)	68.8	36.1	25.3
NP growth	80.0	(89.3)	796.3	40.2	28.4
EPS growth	79.9	(89.3)	798.3	40.3	28.4
EBITDA growth	30.3	(20.9)	56.0	24.9	19.1
Profitability (%)					
OP margin	5.8	3.8	5.2	5.5	6.4
NP margin	4.5	0.5	3.4	3.8	4.5
EBITDA margin	7.8	6.0	7.6	7.5	8.2
ROA	6.9	0.7	5.4	6.5	7.4
ROE	15.6	1.6	13.4	16.3	17.7
Dividend yield	0.7	0.2	0.2	0.2	0.2
Stability					
Net debt (W bn)	195	362	334	403	298
Debt/equity ratio (%)	68.1	86.7	76.5	78.8	58.9
Valuation (X)					
PE	17.1	242.7	34.3	24.5	19.1
PB	2.5	3.9	4.4	3.7	3.2
PS	0.8	1.2	1.2	0.9	0.9
EV/EBITDA	11.1	21.6	17.1	14.0	11.4

Changes to recommendation and price target

Company (Code)	Date	Recommendation	Price target
Hotel Shilla (008770)	09-11-12	BUY	W73,000
	01-28-13	BUY	W53,000
	07-16-13	BUY	W76,000
	01-09-14	BUY	W85,000
	04-14-14	Hold	-



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

- BUY: Expected to give a return of +15% or more
- Hold: Expected to give a return between -15% and 15%
- Underweight: Expected to give a return of -15% or less
- Korea Investment & Securities does not offer target prices for stocks with Hold or Underweight ratings.

■ **Guide to Korea Investment & Securities Co., Ltd. sector ratings for the next 12 months**

- Overweight: Recommend increasing the sector's weighting in the portfolio compared to its respective weighting in the Kospi (Kosdaq) based on market capitalization.
- Neutral: Recommend maintaining the sector's weighting in the portfolio in line with its respective weighting in the Kospi (Kosdaq) based on market capitalization.
- Underweight: Recommend reducing the sector's weighting in the portfolio compared to its respective weighting in the Kospi (Kosdaq) based on market capitalization.

■ **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 Hotel Shilla.

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 Hotel Shilla in the past 12 months;

Korea Investment & Securities Co., Ltd., or its affiliates has not received compensation for investment banking services from Hotel Shilla 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 Hotel Shilla in the next 3 months.

Korea Investment & Securities Co., Ltd., or its affiliates was not making a market in Hotel Shilla's securities at the time that the research report was published.

Prepared by: Jonggil Hong

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.