KIS Korea Daily

Korea Investment & Securities Co., Ltd.

April 3, 2017

Market Performance

	Apr 3	1D	1M	3M	YTD
KOSPI (pt)	2,167.51	0.34	4.27	6.04	6.96
Turnover (W bn)	3,912				
KOSDAQ (pt)	628.52	1.49	4.63	(1.26)	(0.46)

Major Indicators

	Mar 31	1-wk ago	1M ago	end-16
10-yr US Treasury Notes	2.39	2.41	2.39	2.44
3-yr gov't bonds (%)	1.67	1.68	1.67	1.64
AA- corporate bonds (%)	2.13	2.13	2.06	2.14
KRW/USD (won)	1,118.45	1,122.65	1,130.28	1,205.83
KRW/100JPY (won)	1,000.27	1,008.72	1,005.72	1,027.91
JPY/USD (yen)	111.39	111.35	112.77	117.00
USD/EUR (USD)	1.07	1.08	1.06	1.05
WTI (USD/bbl)	50.60	47.97	54.01	53.72
Gold (USD/oz)	1,251.20	1,251.70	1,257.20	1,154.30

Domestic Institutions Net Buy / Sell

Net Buy	(W bn)	Net Sell	(W bn)
Samsung Electronics	28.7	Hyundai Motor	24.6
SK Hynix	23.6	POSCO	24.0
AmorePacific	12.9	Hyundai Mobis	16.3
Hotel Shilla	8.7	Hyundai Steel	14.5
Shinsegae	8.4	Hyundai E&C	11.0

Foreign Net Buy / Sell

Net Buy	(W bn)	Net Sell	(W bn)
SK Hynix	25.7	Samsung Electronics	77.7
Hyundai Motor	13.6	AmorePacific	32.9
KEPCO	11.2	Samsung Biologics	10.8
Nongshim	10.4	NCsoft	8.4
CJ CGV	8.2	LG Chem	6.8

Daily performance by sector

Top five sectors	% chg	Bottom five sectors	% chg
Pharmaceuticals	2.87	Metals	(2.71)
Medical precision	1.93	Transport & storage	(1.95)
Telecom services	1.37	Construction	(1.38)
Electrical/Electronics	0.74	Non-metallic	(0.79)
Retail	0.69	Transport equipment	(0.42)

WHAT'S NEW TODAY

Company & sector note

- **Nongshim** (004370): 1Q17 preview
- **NCsoft** (036570): NDR takeaways
- **Film** (Overweight): 1Q17 box office review
- **Non-life insurance** (Overweight): Time to prepare for a gradual share rebound

Company & sector comment

- **KCC** (002380): 4Q16 audited report analysis

Our market view (for the mid- to long-term)

(%, x)		2016A	2017F	2018F
Corporate earnings	OP growth	20.6	31.9	8.1
	NP growth	9.1	34.6	8.9
Valuation	PE	12.3	9.9	9.0
	PB	1.03	1.02	0.93

Economic forecast

Factors	2016A	1Q17F	2Q17F	3Q17F	4Q17F	2017F
GDP (%)	2.7	2.9	2.7	2.8	3.0	2.9
Private consumption (%)	2.3	1.8	2.1	2.6	3.0	2.4
Facility investment (%)	(3.7)	2.8	3.5	5.1	5.3	4.2
Current account (USD bn)	93.5	16.3	30.3	21.9	30.8	99.3
CPI (%)	1.0	2.1	2.2	2.5	2.6	2.4
KRW/USD (AVG)	1161	1,135	1,150	1,185	1,230	1175
Policy rate (%, EOP)	1.25	1.25	1.25	1.25	1.25	1.25

Note) All figures' growth rates are on YoY basis.

Company & sector note

Nongshim (004370)

Kyoung Ju Lee, 822-3276-6269, kjlee@truefriend.com

BUY (Maintain), TP: W500,000 (Maintain), Close: W310,000 (+3.68%)

1Q17 preview: ASP hike effects visible from 2Q17

▶ We estimate 1Q17 sales will fall 0.7% YoY and OP 9.5% YoY, 9.4% below consensus based on OP. Premium ramen sales should fall to W30bn, after topping W40bn in 1Q16, as the boom in 4Q15-1Q16 wanes. Furthermore, marketing spending to maintain market share has increased as competitors have yet to raise prices. Nongshim lifted ramen prices by 6% at end-2016, but peers are still leaving prices intact. Historically, competitors match price hikes after a three-month lag. But, these companies appear to be delaying price changes this year.

▶ Shares have pulled back recently on concerns that Nongshim would lose market share as Ottogi has left its ramen prices unchanged and on fears that China sales would erode due to the THAAD issue. But, Nongshim's domestic market share should remain above the 2Q16 bottom. Specifically, we estimate market share at 56.7% in 1Q17, compared to 54.2% in 1Q16, 54.0% in 2Q16, 56.0% in 3Q16 and 56.7% in 4Q16. Even if marketing spending is limited, we believe customer migration will be only marginal as the per pack price difference is only W40-50.

▶ We revise down 2017 EPS by 5.0% and 2018 by 4.7% to reflect the THAAD issue (2017 China sales W183.5bn, up 8.4% YoY, OP W10.5bn, up 87.0% YoY). But, we maintain BUY as the revisions are relatively limited and as shares trade at only 28.3x 2017 PE, a discount to global peers. Going forward, we believe the effects of the ramen price hikes will be visible from 2Q17. And, negative effects from early buying ahead of the price hikes should fade after 1Q17, while additional marketing spending that began in 2Q16 should result in better sales of existing products. As such, 2Q17 OP should jump 71.6% YoY (W21.3bn) and 3Q17 OP 72.0% YoY (W39.1bn).

NCsoft (036570)

Andy Kim, 822-3276-6158, askim@truefriend.com

BUY (Maintain), TP: W370,000 (Maintain), Close: W309,000 (+1.31%)

NDR takeaways – Mobile MMORPG shortage compared to demand

▶ We conducted an NDR in the US with NCsoft, and met with 15 institutional investors over three days starting from March 28. While falling Lineage 1 sales fueled some concerns, the focus was mostly on the mobile game strategy, including Lineage M. Going forward, management plans to focus on growing its exposure to mobile MMORPG, which has higher average revenue per paying user (ARPPU) than PC-based games. Given a low weighting of China sales and low expectations for Lineage RK, we believe the ongoing THAAD controversy will have only a limited impact.

▶ By reflecting mobile MMORPG market trends, e.g., auto gameplay, in addition to sophisticated graphics utilizing the Unreal 4 engine, Lineage Revolution has become the leading domestic mobile MMORPG. And, demand for the mobile MMORPG market has grown sharply, but supply is still limited. As such, we believe there is still significant demand for Lineage M, the second game to be developed domestically. Of the Lineage Revolution users, less than 30% are Lineage 1 players. And, Lineage M should secure a robust user base among existing online game users. Of note, the core target market is older players familiar with Lineage 1, rather than younger players in their 20s-30s. As such, relatively poor graphics on Lineage Revolution should have only a marginal impact.

▶ Despite concerns, NCsoft is reinforcing its position in the mobile game market. Lineage RK ranked first in both domestic app markets despite a negative initial response. Furthermore, Final Blade and H2 (sports genre) are also beating expectations. As such, expectations are rising for Lineage M. If the game is a success, this should lift hopes for Aion Mobile, which is scheduled to launch in 2H17. Overall, momentum concerns should fade sharply after the launch of Lineage M. Backed by the successful games, we believe NCsoft will secure: 1) high-quality IP, 2) solid publishing games, and 3) a robust developer workforce.

▶ We maintain BUY with a TP of W370,000 (19.7x 12MF PE) as concerns over a delayed Lineage M launch have faded. Furthermore, NCsoft should benefit given: 1) a robust user base given 3.8mn dormant users, 2) Lineage M will be the only domestic mobile MMORPG, excluding Lineage Revolution, and 3) Lineage M sales may beat market expectations due to the item trading function, which was a core element to Lineage 1. Furthermore, the success of H2 has further confirmed NCsoft's mobile competitiveness, as sales exceed that of other baseball games.

Film (Overweight)

Minha Choi, 822-3276-6260, mhchoi@truefriend.com

1Q17 box office Review: A silver lining

▶ Korea's box office expanded in 1Q17 on successful domestic and foreign movies. Specifically, total box office ticket sales reached W422.4bn (+8.3% YoY) as 52.2mn (+5.6% YoY) tickets were sold. Confidential Agreement (released January 15) and The King (January 18) both targeted the Lunar New Year holiday, and these films, in addition to other domestic movies (Fabricated City, February 9, 2.5mn tickets sold; New Trial, 2.4mn tickets sold), posted robust results. January-February results edged up only 3.2% YoY, but March ticket sales surged 25.2% YoY, lifting quarterly results. Of note, Korean movie ticket sales increased 7.3% YoY during 1Q17 while foreign movie ticket sales improved 9.4% YoY.

▶ China's box office reached CNY14.5bn in 1Q17, flat YoY. Due to the different timing of the Lunar New Year, January box office jumped 27.8% YoY while February contracted 10.0% YoY and March 10.3% YoY. Given the record success of the Mermaid (February 8, 2016) last year, the flat results are viewed as a success. Of note, The Mermaid sold 9.2mn tickets, generating sales of CNY339.2bn.

▶ We forecast the film market will post robust growth this year as sequels to popular foreign titles and major domestic films in Korea and China are scheduled for release. Given the movie lineup (Table 3), both domestic and foreign films should contribute equally to growth in 2Q17. Of note, China's box office edged up only 3.6% YoY in 2016 due to poor 2Q16 results. Specifically, China's box office surged 50.8% in 1Q16 fueled by The Mermaid, but growth slowed sharply as results were poor in the rest of the year (2Q16 -4.9% YoY, 3Q16 -13.4% YoY, 4Q16 -9.2% YoY). We believe China's box office will resume structural growth after bottoming in 1Q17 due to the high Mermaid base effect.

Non-life insurance (Overweight)

Taeho Yoon, 822-3276-5956, taeho3123@truefriend.com

Time to prepare for a gradual share rebound

▶ Combined NP at the six non-life insurers reached W237.9bn (+16.3% YoY, -49.1% MoM) in February. 1) The sharp MoM decline is mainly due to a W260bn one-off gain from sale of Samsung F&M's headquarters in January. 2) NP climbed 16.3% YoY as average auto loss ratio fell 2.6%p YoY or 3.5%p MoM. 3) Risk loss ratios rose overall as claims were pushed back to February due to the Lunar New Year in January and two additional business days in February. Of note, Samsung F&M's risk loss ratio normalized to 78.9%, falling 3.2%p YoY, from the unusually high level last year.

▶ March NP should decline, due to: 1) more business expenses on additional marketing expenses and a larger amortization burden, and 2) high risk loss ratio from more claims on additional business days. However, as earnings at the six non-life insurers were solid in January-February, 1Q17 results should beat consensus. Specifically, we believe Samsung F&M will reach 50% of its annual guidance in 1Q17 alone due to the sale of its headquarters in 1Q17 and dividend income from Samsung Electronics. Accordingly, we believe Samsung F&M (annual guidance W925bn) will post solid 1H17 results and weaker 2H17 earnings. Dongbu Insurance and Meritz F&M should also beat 1Q17 consensus given robust January-February results (96.3% and 101.4% of consensus during the two-month period, respectively). Hyundai M&F, KB Insurance and Hanwha Insurance should be in line with consensus.

▶ Since the start of the year, non-life shares have underperformed the Kospi and other finance sectors, on: 1) concerns over capital adequacy stemming from rising interest rates, and 2) concerns over excessive competition. Both factors are critical to enterprise value and full-year earnings direction, so concerns should linger. Despite the near-term effects of rising interest rate, we believe concerns are excessive as the higher rates are clearly benefiting enterprise value. Furthermore, second-tier non-life insurers are pacing subordinated debt issuances, and these should be absorbed by the market without any major turbulence given earlier efforts by Hanwha Life. Given the monthly NP buffer and the position of vulnerable major shareholders, rights offerings appear unlikely (excluding financial holding company subsidiaries).

Company & sector comment

KCC (002380)

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BUY (Maintain), TP: W450,000 (Maintain), Close: W352,000 (-0.56%)

4Q16 audited report analysis: Defending P amid poor conditions

▶ Based on an analysis of the audited report, we attribute the poor 4Q16 earnings to: 1) W20bn in bad debt expenses for long-term receivables, which appears to have been reflected in paint SG&A expenses, and 2) W70.4bn in impairment losses for the Saudi Arabian polysilicon subsidiary (PTC), which was booked as non-operating expenses. Paint sales edged down 2% YoY on a 1% decline in output and unit price cuts, while construction material sales improved 3% YoY. Sales of organic silicon and other products jumped 12% YoY, but HomeCC sales dropped 15% YoY. OP plunged 86% YoY on paint impairment losses and an 11% YoY decline in construction materials.

▶ While construction material sales were robust in 2016, pricing pressure was significant and shipbuilding/industrial coating sales volume deteriorated. Among all products, the price of gypsum board (up 1.6% YoY in 2016) is the only to rise on a supply-demand imbalance; so the timely capacity expansion is even more positive. Of note, there was no pricing erosion for products with fewer competitors, such as mineral insulation and sealants. But, the prices of industrial coatings (-7.4% YoY) and construction/shipbuilding paints (-4.6% YoY) have been falling since 2015.

▶ In 2017, we believe construction materials will depend more on P rather than Q. Shipbuilding-related steel product prices appear to be climbing in 1Q17, which should result in higher shipbuilding paint prices. According to recent media reports, prices should begin rising for some products soon as the big three players, LG Hausys, KCC and Hanwha L&C, will lift PVC window prices by 8%.

▶ Despite difficulties in the shipbuilding and auto sectors during 2013-2016, KCC has been posting steady growth. In 2017, we believe the company will continue to post stable results as it defends product prices. However, KCC shares have been tightly correlated to Samsung C&T shares over the past six months (correlation coefficient 0.9). While this is partly unavoidable as Samsung C&T accounts for more than half of KCC's market cap, we believe shares have no priced in the robust earnings capacity. Once Samsung C&T shares stabilize, we believe KCC shares will begin reflecting the solid operating value.

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