

Korea Kolmar (161890)

12M rating **BUY (Initiate)**

12M TP **W33,000**

Up/downside

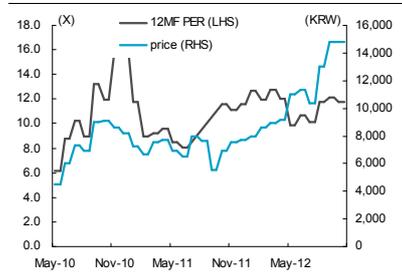
Stock Data (pre-spinoff data)

KOSPI (Oct 18, pt)	1,959
Stock price (Oct 18, KRW)	14,800
Market cap (USD mn)	373
Shares outstanding (mn)	9
52-Week high/low (KRW)	14,800/6,380
6M avg. daily turnover (USD mn)	7.3
Free float / Foreign ownership (%)	78.6/15.5
Major shareholders (%)	
Dong-Han Yoon and 3 others	19.5
Nihon Kolmar	14.3

Performance

	1M	6M	12M
Absolute (%)	5.7	69.1	132.0
Relative to KOSPI (%p)	8.0	71.4	125.4

12MF PER trend



Source: WISEfn consensus

Positioned to surge after three-week break

Initiate coverage with BUY and TP of W33,000

We initiate coverage on Korea Kolmar, an operating company listed on Oct 19 after being spun off, with a BUY rating and TP of W33,000. Based on pre-split data, our TP equates to W22,506 or a target market cap of W648.1bn. Of note, Korea Kolmar Holdings is not part of the KIS universe. Our TP is based on 24x 2013 PE (historic high versus small- and mid-sized cosmetics average of 27x). We believe shares will rally to a historic high PE, given: 1) improving margins (2012-2016 EPS CAGR of 30%) on the strong cosmetics business and pharmaceuticals ODM turnaround, 2) Kolmar Beijing reaching BEP soon, and 3) exports to a global premium brand in 2013. To reflect the faster-than-expected margin growth, we revise up our OP estimate by 21.2% for 2012 and 16.5% for 2013 compared to pre-split forecasts.

Operating fundamentals intact after spin off

We believe the spin off will have no material impact on Kolmar's operating fundamentals as the operating company will maintain control of the main businesses (cosmetics, pharmaceutical original design manufacturing and Beijing Kolmar). In addition, estimate-beating OP growth at the operating company and Beijing Kolmar should more than offset NP erosion (down 20% from pre-spin off 2013 NP forecast) due to subsidiary transfers (Kolmar Pharma, Sun Biotech, etc) to the holding company.

2QFY12 earnings surprise likely; earnings to remain solid in 2HFY12 and 2013

After posting poor 1QFY12 (end Jun) OP, Kolmar should post an earnings surprise in 2QFY12. Specifically, we believe the company will post sales of W91.8bn (+34.8% YoY) and OP of W10.3bn (+134.3% YoY, 11.2% OPM), beating our earlier estimates by 12% and 92%, respectively. We believe the profit growth will be catalyzed by: 1) increasing sales of high-priced cosmetics, such as sun block creams, and 2) improving sales at the high-margin pharmaceuticals division (+15.9% YoY, +14.8% QoQ). Given the boom in the low- to mid-range cosmetics market and drug price cuts, pharmaceutical players have increased outsourcing orders, suggesting Kolmar's earnings will remain solid in 2HFY12 (sales to grow 19% YoY, OP 79.4% YoY). While sales growth is forecast to slow in 2013 (+17% YoY) due to a high base effect, NP should surge 27.3% YoY on OP improvement and EBT contributions from Beijing Kolmar.

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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)	(%)
2010A	260	13	12	11	402	(8.0)	18	18.7	12.9	1.9	10.7
2011A	303	16	13	19	651	62.1	22	13.8	13.8	1.9	15.4
2012F	375	28	24	21	1,088	67.1	34	13.4	7.7	1.9	15.2
2013F	439	34	31	27	1,386	27.3	41	10.5	6.7	1.7	17.1
2014F	506	42	40	35	1,811	30.7	51	8.1	5.5	1.4	19.2

Note: Before separation for 2010-2011A, 2012-2014F PE based on the KRX' base price (W14,600)

Operating company shares to surge first: strong earnings to be priced in and valuation gap with peers to narrow

After the spin off, the typical divergence in shares between the holding company and operating company should be repeated with Kolmar. Once trading resumes, short-term upside should be significant for the operating company, which controls the core businesses. We expect shares to rally over the near term, on: 1) fading discount factors, such as sluggish earnings – poor 1QFY12 OP was a major drag on shares – and weakness in overseas markets, and 2) a narrowing valuation gap with small- and mid-sized cosmetics peers, which widened during the trading suspension. Immediately prior to the separation, Kolmar shares traded at 13.4x 2012 PE and 10.5x 2013 PE (based on KRX base price), compared to 33x 2012 PE and 24x 2013 PE for Cosmax.

Holding company to complete shift by yearend via investment in-kind (share swap)

Immediately after re-listing, holding company shares should trade at W6,503-7,650 (1.1-1.3x 2013 PB, market cap W59-69bn), a 58-65% discount to the base price (W15,000). Korea Kolmar plans to complete the holding company adoption process by yearend via investment in-kind using a third-party rights allocation (largest shareholder and related parties). Assuming shares are split according to the separation ratio (holding company 0.325: operating company 0.675), the holding company should issue 8.28mn shares (9.07mn outstanding shares after separation). And, the majority shareholder should have a 58.8% stake of the holding company, and the holding company should have a 22% stake in the operating company. After the rights issue, holding company shares are estimated at W4,870 (W9,315 based on number of shares pre-rights offering; market cap W84.5bn, 40% NAV discount, 1.6x 2013 PB, 13% discount compared to operating company). While the holding company is not an attractive short-term play, we believe value will grow over the long term, backed by the pharmaceutical ODM and health supplement businesses.

Table 1. Earnings revisions (pre and post spin-off)

(W bn, W, %, 000 shares)

	2012F		2013F		Diff %	
	Before	After	Before	After	2010F	2011F
Sales	351	375	415	439	7.0	5.6
Operating profit	23	28	29	34	21.2	16.5
Pre-tax profit	20	24	31	31	17.6	(1.5)
Net profit	18	21	27	27	17.6	(1.5)
OP margin (%)	6.6	7.4	7.0	7.7		
EPS	625	1,088	960	1,386	74.2	44.4
Number of shares (000)	28,865	19,481	28,565	19,481	(32.5)	(31.8)

Source: Company data, Korea Investment & Securities

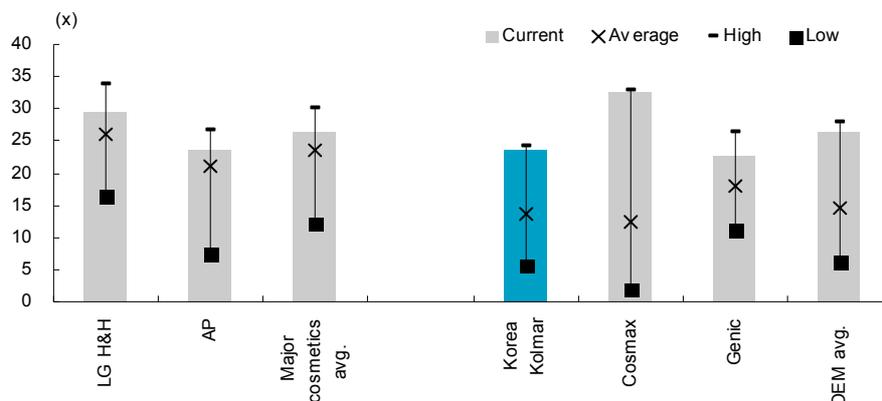
Table 2. Valuation scenario analysis

(W bn, W, %)

	2013F target PER	Valuation method	Value per share (KRW)		U/D compared to listing price	
			Pre spin-off	Post spin-off	Pre spin-off	Post spin-off
Scenario 1	21.0X	Previous target PE, 10% discount to historical high	19,851	29,107	36.0	99.4
Scenario 2 (base case)	24.0X	Historical high	22,687	33,266	55.4	127.8
Scenario 3	26.0X	10% premium to historical high, current 2012F ODM peer avg.	24,578	36,038	68.3	146.8

Source: Korea Investment & Securities

Figure 1. 2012F cosmetics peer valuation comparison



Note: Korea Kolmar based on pre-spinoff data
 Source: Company data, Korea Investment & Securities

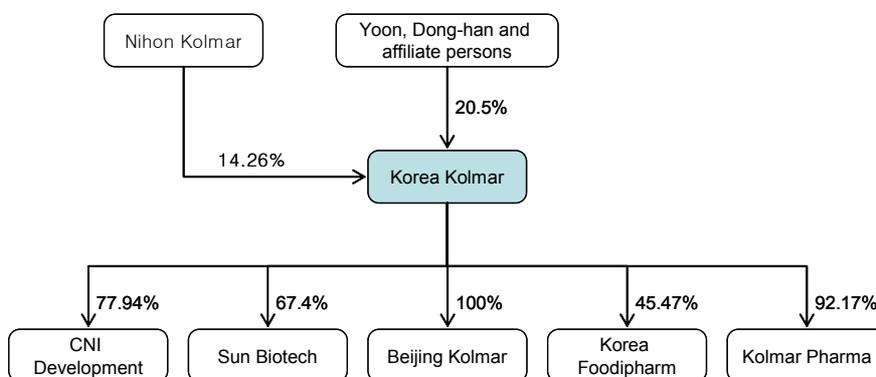
Table 3. Business separation

(W bn, %)

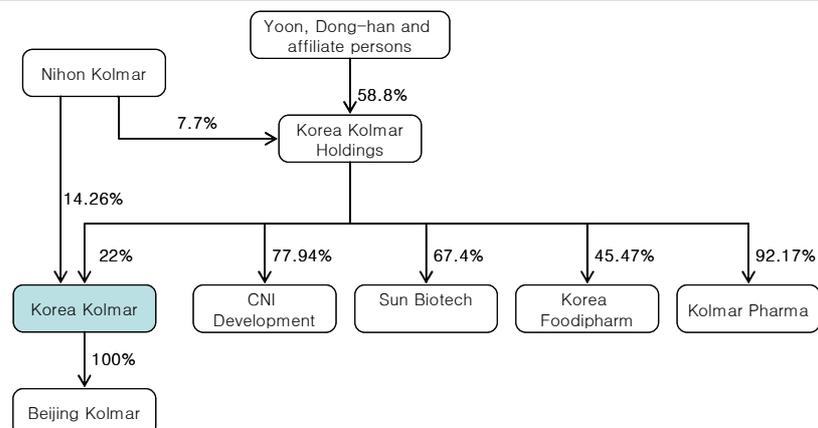
	Pre spin-off (W bn)	Post spin-off (%)	
		Korea Kolmar Holdings (continuing entity)	Korea Kolmar (new operating company)
Total assets	265	27.1	73.4
Current assets	137	11.8	88.2
Cash & cash equivalents	30	41.0	59.0
Investment in properties	10	100.0	0.0
Investments in associates/subsidiaries	31	82.5	17.5
Total liabilities	133	20.8	79.2
Short-term borrowings	49	33.8	66.2
Long-term borrowings	12	45.4	54.6
Shareholder's equity	132	33.6	67.5
Capital stock	14	32.5	67.5
Retained earnings	76	100.0	0.0

Source: Dart

Figure 2. Korea Kolmar's ownership structure (pre holding company)



Source: Dart, Korea Investment & Securities

Figure 3. Korea Kolmar's ownership structure (post split and holding company's rights issue)

Source: Dart, Korea Investment & Securities

Table 4. Fair value of holding company

(W bn, W, mn share, %)

	Method	Value (Before investment in kind)	Value (After investment in kind)
Value of investment assets	Korea Kolmar mkt. cap stake value (22%)	62.7	
Value of tangible assets	Real estate	9.6	
Value of other subsidiaries (unlisted)		78.3	
Sun Biotech	10x 2013 NP (50% discount to avg. of Korean top-tier pharma companies)	65.8	
CNI development	2011A BV	4.2	
BRN Science (Kolmar Pharma)	10x 2013 NP (50% discount to avg. of Korean top-tier pharma companies)	7.5	
Korea Foodipharm	10x 2011A BV	0.8	
Total value		151	
Net debt (net cash)	2011A	9.7	
NAV		141	141
NAV discount (%)		40.0	40.0
Number of shares (mn)		9.1	17.4
Fair equity value per share (W)		9,314.8	4,868.9

Source: Company data, Korea Investment & Securities

Table 5. Scenario analysis on fair value of holding company in terms of stake value in operating company (% , KRW, x)

Scenario	Method	Stake in operating company (%)	Fair value per share (40% NAV discount)		PBR before payment in kind		
			Before payment in kind	After payment in kind	2011A	2012F	2013F
1	Operating company mkt. cap based on the listing price	1.1	5,370	2,807	1.2x	1.0x	0.9x
2	-15% to lowest Kolmar Holdings asking price		6,503	3,399	1.4x	1.3x	1.1x
3	Operating company target mkt. cap	1.1	4,236	2,214	0.9x	0.8x	0.7x
4	Operating company mkt. cap based on the listing price (base case)	22.0	9,315	4,869	2.0x	1.8x	1.6x
5	Operating company target mkt. cap	22.0	14,616	7,640	3.2x	2.9x	2.4x
6	32.5% of mkt. cap before spin-off		15,097	7,891	3.3x	3.0x	2.5x
7	+15% to lowest Kolmar Holdings asking price		35,190	18,394	7.7x	6.9x	5.9x

Source: Korea Investment & Securities

Table 6. Base prices announced by KRX

(KRW)

Company	Stock type	Listing price (W)	Lowest asking price	Highest asking price	Trading range after price decision
Korea Kolmar	Common stock	15,300	7,650	30,600	6,503-35,190
Holdings	+15% change	17,595	8,798	35,190	
	-15% change	13,005	6,503	26,010	
Korea Kolmar	Common stock	14,600	7,300	29,200	6,205-33,580
(operating company)	+15% change	16,790	8,395	33,580	
	-15% change	12,410	6,205	24,820	

Note: Based on KRX' announcement on Oct 18, 2012; Initial price to be set based at 9am and to trade within +15% and -15% of the price

Source: KOSCOM

Table 7. Quarterly earnings

(W bn, %)

	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11	3Q11	4Q11	1Q12	2Q12F	% QoQ	% YoY	% diff.	KIS estimates
Sales	57.8	58.8	72.8	70.2	75.6	68.1	77.3	81.5	94.0	91.8	(2.3)	34.8	12.3	81.7
Cosmetics	40.2	42.5	52.8	50.8	54.2	45.6	54.9	59.9	71.3	65.8	(7.7)	44.3		57.6
Pharmaceutical	16.8	16.0	19.4	18.9	21.1	22.1	22.0	21.2	22.3	25.6	14.8	15.9		23.7
Others	0.8	0.4	0.6	0.5	0.4	0.4	0.4	0.4	0.4	0.4	0.0	(1.2)		0.4
COGS	47.4	46.6	60.1	59.9	62.6	55.0	65.3	67.8	79.9	72.1	(9.7)	31.2	7.0	67.4
Gross Profit	10.3	12.2	12.7	10.3	13.0	13.2	12.0	13.7	14.1	19.7	39.5	49.8	37.7	14.3
SG&A	6.1	8.1	7.4	7.7	8.5	9.3	9.2	9.8	9.5	9.5	(0.3)	2.2		9.0
Other OP					0.5	0.5	0.1	0.1	0.4	0.1	(68.6)	(79.4)		0.1
Other OP expense					0.2	0.0	0.0	0.0	0.2	0.0	(77.1)	5.3		0.0
OP	4.2	4.1	5.3	2.6	4.8	4.4	3.0	3.9	4.8	10.3	115.2	134.4	91.9	5.4
OP margin (%)	7.3	7.0	7.2	3.7	6.3	6.5	3.8	4.8	5.1	11.2				6.6

Source: Company data, Korea Investment & Securities

Balance sheet

FY-ending Dec. (W bn)	2010A	2011A	2012F	2013F	2014F
Current assets	105	112	136	149	172
Cash & cash equivalent	12	7	4	4	5
Accounts & other receivables	44	61	75	88	101
Inventory	34	33	41	48	56
Non-current assets	107	133	111	150	162
Investment assets	27	47	8	27	31
Tangible assets	59	66	87	93	97
Intangible assets	8	8	3	12	14
Total assets	211	245	247	299	334
Current liabilities	76	99	148	167	167
Accounts & other payables	49	53	60	70	81
ST debt & bond	15	39	32	33	34
Current portion of LT debt	10	5	0	0	0
Non-current liabilities	17	22	9	17	19
Debentures	4	4	0	0	0
LT debt & financial liabilities	9	13	5	12	13
Total liabilities	93	121	157	184	186
Paid-in capital	14	14	10	10	10
Capital surplus	44	44	80	80	80
Capital adjustments	0	(2)	0	0	0
Retained earnings	60	68	0	25	58
Shareholders' equity	119	124	90	115	148
Adj. shareholders' equity	112	131	148	169	199

Cash flow

FY-ending Dec. (W bn)	2010A	2011A	2012F	2013F	2014F
C/F from operating	8	8	17	31	19
Net profit	11	12	21	27	35
Depreciation	4	5	6	7	7
Amortization	0	1	0	1	1
Net incr. in W/C	(14)	(12)	(8)	(3)	(22)
Others	5	3	(2)	(1)	(2)
C/F from investing	(21)	(34)	13	(36)	(19)
CAPEX	(10)	(12)	(27)	(13)	(11)
Decr. in fixed assets	0	0	0	0	0
Incr. in investment	(6)	(19)	41	(19)	(1)
Net incr. in intangible assets	(1)	(1)	5	(10)	(3)
Others	(4)	(2)	(7)	6	(3)
C/F from financing	8	20	6	6	(0)
Incr. in equity	4	0	31	0	0
Incr. in debts	6	23	(24)	8	2
Dividends	(3)	(3)	(3)	(2)	(2)
Others	1	0	2	0	0
C/F from others	0	(0)	0	0	0
Increase in cash	(5)	(6)	*37	0	1

- Note: 1. Based on K-IFRS (non-consolidated)
2. EPS and BPS are calculated using adjusted net profit and shareholders' equity that includes equity-method gains/losses
3. Before separation for 2010-2011A
4. Based on 2011-2012 balance sheet; Due to the difference between before and after separation, cash increase on the cash flow statement and actual amount do not match

Income statement

FY-ending Dec. (W bn)	2010A	2011A	2012F	2013F	2014F
Sales	260	303	375	439	506
Gross profit	46	52	68	81	95
SG&A expense	29	37	41	48	54
Other operating gains	(3)	1	1	1	2
Operating profit	13	16	28	34	42
Financial income	3	2	2	2	2
Interest income	0	0	0	0	0
Financial expense	4	4	4	4	4
Interest expense	2	3	3	2	3
Other non-operating profit	0	0	(4)	(2)	(2)
Gains (Losses) in associates, subsidiaries and JV	0	(0)	2	1	3
Earnings before tax	12	13	24	31	40
Income taxes	1	2	3	4	5
Net profit	11	12	21	27	35
Other comprehensive profit	(0)	(1)	0	0	0
Total comprehensive profit	11	11	21	27	35
EBITDA	18	22	34	41	51
Adj. net profit	11	19	21	27	35

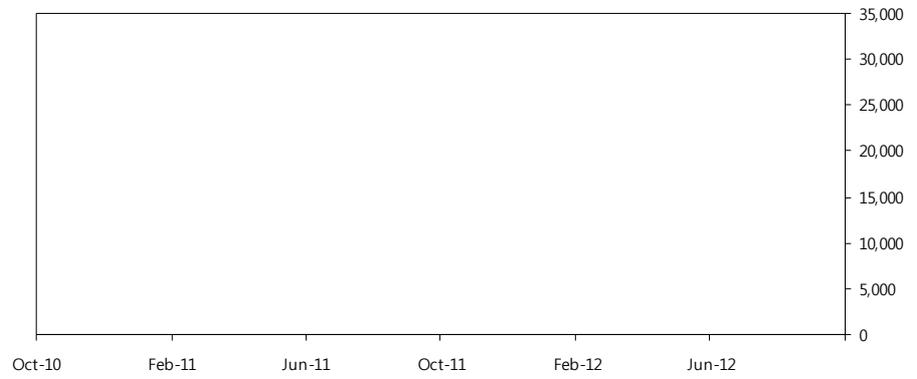
Key financial data

FY-ending Dec.	2010A	2011A	2012F	2013F	2014F
per share data (KRW)					
EPS	402	651	1,088	1,386	1,811
BPS	3,876	4,628	7,572	8,674	10,227
DPS	100	105	105	105	105
Growth (%)					
Sales growth	38.0	16.5	24.0	16.9	15.3
OP growth	(3.3)	22.3	73.8	21.4	24.1
NP growth	(4.3)	66.6	13.3	27.3	30.7
EPS growth	(8.0)	62.1	67.1	27.3	30.7
EBITDA growth	(1.2)	21.1	55.6	22.3	21.9
Profitability (%)					
OP margin	5.0	5.3	7.4	7.7	8.3
NP margin	4.3	6.2	5.7	6.2	7.0
EBITDA margin	6.9	7.2	9.0	9.5	10.0
ROA	5.8	5.1	8.6	9.9	11.2
ROE	10.7	15.4	15.2	17.1	19.2
Dividend yield	1.3	1.2	0.7	0.7	0.7
Stability					
Net debt (W bn)	14	44	19	34	35
Debt/equity ratio (%)	32.5	49.4	41.5	39.4	31.9
Valuation (X)					
PER	18.7	13.8	13.4	10.5	8.1
PBR	1.9	1.9	1.9	1.7	1.4
PSR	0.8	0.9	1.1	0.6	0.6
EV/EBITDA	12.9	13.8	7.7	6.7	5.5

Note: 2012-2014F PE based on the KRX' base price (W14,600)

Changes to recommendation and price target

Company (Code)	Date	Recommendation	Price target
Korea Kolmar (161890)	10-19-12	BUY	W33,000



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- Hold: Expected to give a return between -15% and 15%
- Underweight: Expected to give a return of +15% or less
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Prepared by: Jung-In Lee

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