

## Lotte Chilsung Beverage (005300)

12M rating **BUY (Maintain)**  
12M TP **W2.5mn** from W3.1mn  
Up/downside **+96%**

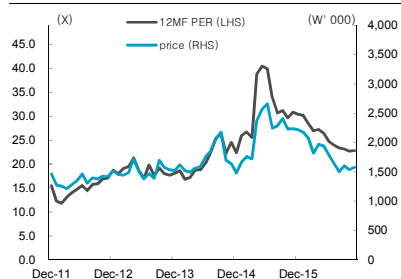
### Stock Data

KOSPI (Nov 3, pt)	1,984
Stock price (Nov 3, KRW)	1,579,000
Market cap (USD mn)	1,714
Shares outstanding (mn)	1
52-Week high/low (KRW)	2,426,000/1,501,000
6M avg. daily turnover (USD mn)	4.5
Free float / Foreign ownership (%)	45.8/16.9
Major shareholders (%)	
Gyeong-Ho Shin and 8 others	54.2
NPS	10.4

### Performance

	1M	6M	12M
Absolute (%)	(1.3)	(22.5)	(27.0)
Relative to KOSPI (%p)	1.6	(22.4)	(23.8)

### 12MF PE trend



Source: WISEfn consensus

## Lots to win, little to lose

### 3Q16 earnings to be in line with consensus

We estimate Lotte Chilsung Beverage will post 3Q16 earnings that are in line with consensus as sales should grow 4.7% YoY and OP 6.2% YoY. Earnings should improve as beverage sales grow 7-8% YoY due to hot weather. Specifically sales at the cash cow carbonated beverage and canned coffee unit should improve 4-6% YoY while bottled water surges more than 20% YoY, sustaining solid growth. Tea, which has decreased over the past several years, should also rebound 10% YoY due to the hot weather. As for juice, which has also been sluggish, sales should be flat YoY. Meanwhile, we estimate liquor sales should fall 5% YoY on a high base effect. Specifically, Soonhari sales should decline from W9bn in 3Q15 to W3bn, while whiskey and other liquor sales drop 7% YoY. In contrast, sales of existing soju products should climb 6% on a price hike. The overall beer market should contract due to the hot weather. Kloud is expected to decline about 6%, which is solid compared to competitors. Profitability should improve on cheaper raw material costs and easing market competition.

### Beer price hike likely

We forecast earnings growth will accelerate from 4Q16. As OB raised prices 6% on November 1, a price hike for Kloud appears more likely. Currently, Kloud retails for 15.8% more than Cass and Hite. If Lotte Chilsung does not raise prices, volume may increase but we believe the company is more likely to lift prices to maintain the gap with mass market products. While Lotte Chilsung is expected to complete a second beer factory by end-2Q17, we believe this facility will be used to manufacture a mass market product given the company's goal of becoming the leader in the beer market. As such, it would be necessary to differentiate product prices, suggesting a Kloud price hike is more likely. Lotte Chilsung's EPS should improve 4.3% on 2016 beer sales of W93.3bn and a 6% price hike. 2017 beer sales are forecast at W164.4bn, which would lift EPS by 7.5%, assuming the new facilities are online for six months.

### EPS to grow rapidly if beverage prices are raised

Beverage price hikes also appear likely. Coca Cola raised prices by 5% from November 1, including carbonated beverages. Among processed foods, beverage price hikes are the most frequent. Considering Lotte Chilsung has not raised prices since January 2015, we believe markups are likely in January 2017. 2016 beverage sales are forecast at W1.45tn, and EPS should improve by 11.6% on a 1% price hike. If prices are raised 3% considering that Lotte Chilsung has a more diverse SKU than Coca Cola, EPS could improve as much as 34.8%. We forecast

Yr to	Sales	OP	NP	EPS	% chg	EBITDA	PE	EV/EBITDA	PB	ROE	DY
Dec	(W bn)	(W bn)	(W bn)	(KRW)	(YoY)	(W bn)	(x)	(x)	(x)	(%)	(%)
2014A	2,184	93	19	13,754	(81.5)	216	108.0	12.4	0.9	0.8	0.3
2015A	2,299	143	100	73,389	433.6	276	30.2	13.2	1.3	4.3	0.4
2016F	2,380	163	92	67,725	(7.7)	325	22.7	9.2	0.9	3.9	0.6
2017F	2,561	188	104	76,555	13.0	392	20.1	8.0	0.8	4.3	0.6
2018F	2,771	234	140	102,905	34.4	457	14.9	6.3	0.8	5.5	0.7

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

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beverage ASP will rise 2% and parent COGS 2.7%.

### Concerns fade and more positives emerge, F&B top pick

We revise down our TP from W3,100,000 to W2,500,000 reflecting lower stock prices of domestic affiliates, including Lotte Shopping and Lotte Food, to maintain conservatism and to reflect the postponed development of the Seocho property. We also lifted our discount from 10% to 20% to reflect uncertainty in the beer business as competition grows. Despite the lower TP, we recommend BUY as Lotte Chilsung remains our top F&B pick. In addition to a 58.3% upside, there are additional investment points, including: the likely price hikes for core products, rising affiliate stake value as corporate governance improves and likely improvements overseas, including Pakistan, as a Pepsi bottler. If Lotte Chilsung disposes of affiliate stakes during the governance restructuring, this should fully ease the capex burden for the second beer factory and lift corporate value. There is still uncertainty regarding beer marketing, but this has been fully priced into shares as it has been reflected over the past year. We believe this is an opportunity for Lotte Chilsung to offset higher costs through price hikes, but shares have not rallied at all. Furthermore, management has historically tied beer marketing costs to sales.

**Table 1. 3Q16 preview**

(W bn, %)

	3Q16F	3Q15	YoY	2Q16	QoQ	Consensus	Diff.
Sales	676.0	645.5	4.7	628.5	7.6	673.0	0.5
Gross profit	294.1	277.9	5.8	279.6	5.2		
SG&A	236.6	223.8	5.7	228.9	3.4		
OP	57.5	54.1	6.2	50.7	13.3	57.5	(0.0)
Financial income	47.2	47.7	(1.2)	39.8	18.5	49.9	(5.5)
Financial costs	33.5	34.2	(1.9)	28.9	15.8	36.5	(8.1)
EBT	56.5	56.9		55.5			
Controlling-int. NP	35.0	34.7		36.4			
COGS-to-sales	8.5	8.4		8.1		8.5	
SG&A-to-sales	7.0	7.4		6.3		7.4	
OP margin	5.0	5.3		4.6		5.4	
EBT margin	676.0	645.5	4.7	628.5	7.6	673.0	0.5
NP margin	294.1	277.9	5.8	279.6	5.2		

Source: Quantiwise, Korea investment and securities

**Table 2. SotP valuation**

(W bn, KRW)

	Stake value (W bn)"	Stake value per share (KRW)	Valuation Method
<b>Operating value(A)</b>	3,545	2,865,471	DCF(WACC 5.8%, ROIC 5.8%, g 2%)
Beverage, Soju, Whiskey	2,922	2,361,619	
Beer	623	503,852	
<b>Non-operating value(B)</b>	1,296	1,047,910	
<b>Equity Investment</b>	438	354,350	
Pepsi-Cola	75	60,390	30% discount after applying market value
Philippines			
Listed	260	209,778	30% discount after applying market value
Unlisted	104	84,183	50% discount after applying book value of 2Q16
<b>Seocho development</b>	858	693,560	50% present value of expected cash flow assuming presale in 2019
<b>Net Debt(C)</b>	837	676,271	2Q16
<b>Preferred stocks(D)</b>	85	69,059	Market value
<b>Total(A+B-C-D)</b>	3,920	3,168,051	
<b>Liquidity discount rate</b>	10%	20%	Considering low liquidity
<b>Target Value</b>	3,528	2,534,440	

Source: Bloomberg, Korea Investment & Securities

**Table 3. EPS sensitivity by beverage ASP and raw-material cost change**

		Beverage ASP growth rate								
		-8.0%	-6.0%	-4.0%	-2.0%	0.0%	1.0%	4.0%	7.0%	10.0%
Raw material cost change rate	-8.0%	-39.1%	-15.8%	7.4%	30.7%	53.9%	65.6%	100.4%	135.3%	170.2%
	-6.0%	-52.5%	-29.3%	-6.0%	17.2%	40.5%	52.1%	87.0%	121.8%	156.7%
	-4.0%	-66.0%	-42.8%	-19.5%	3.7%	27.0%	38.6%	73.5%	108.3%	143.2%
	-2.0%	-79.5%	-56.3%	-33.0%	-9.8%	13.5%	25.1%	60.0%	94.9%	129.7%
	0.0%	-93.0%	-69.7%	-46.5%	-23.2%	0.0%	11.6%	46.5%	81.4%	116.2%
	1.0%	-99.7%	-76.5%	-53.2%	-30.0%	-6.7%	4.9%	39.8%	74.6%	109.5%
	4.0%	-120.0%	-96.7%	-73.5%	-50.2%	-27.0%	-15.3%	19.5%	54.4%	89.3%
	7.0%	-140.2%	-117.0%	-93.7%	-70.5%	-47.2%	-35.6%	-0.7%	34.2%	69.0%
	10.0%	-160.4%	-137.2%	-113.9%	-90.7%	-67.4%	-55.8%	-20.9%	13.9%	48.8%

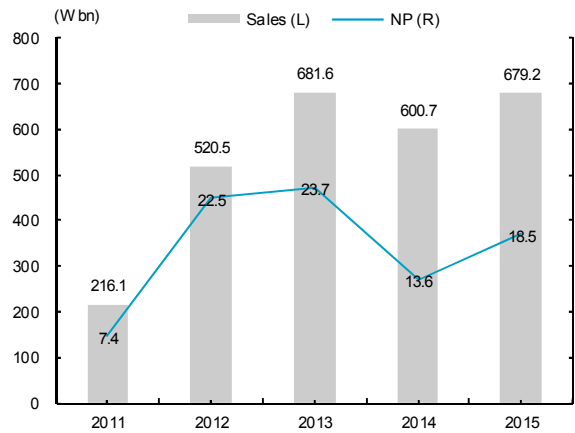
Source: Korea Investment &amp; Securities

**Table 4. Beer earnings forecast**

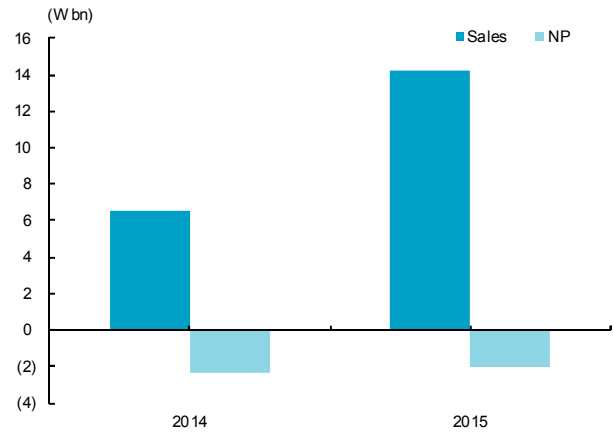
(Unit: W bn, %)

	2014	2015	2016F	2017F	2018F	2019F	2020F	2021F
Sales	44.4	95.1	93.3	163.4	244.4	265.3	288.2	336.2
COGS	31.7	60.7	62.6	101.5	140.9	149.7	159.4	188.5
Depreciation	6.3	11.1	11.1	24.4	37.8	37.8	37.8	40.0
Material cost	11.1	28.5	28.0	49.0	61.1	66.3	72.0	84.0
Labor cost, etc.	14.3	21.1	23.5	28.1	42.0	45.6	49.5	64.5
SG&A	46.9	54.6	54.4	85.5	105.3	99.7	103.7	112.4
Labor cost	2.5	5.3	5.2	9.1	18.6	20.2	21.9	18.8
Marketing fee	40.0	39.8	39.9	60.0	62.3	53.0	53.0	60.0
Others	4.4	9.5	9.3	16.3	24.4	26.5	28.8	33.6
OP	-34.2	-20.3	-23.7	-23.6	-1.8	15.9	25.1	35.2
(% to sales)								
COGS	71.4	63.9	67.1	62.1	57.6	56.4	55.3	56.1
SG&A	105.6	57.5	58.3	52.3	43.1	37.6	36.0	33.4
OP	(77.0)	(21.3)	(25.4)	(14.4)	(0.7)	6.0	8.7	10.5
Marketing fee	90.0	41.9	42.7	36.7	25.5	20.0	18.4	17.8
(%, YoY)								
Sales		114.0	(1.9)	75.1	49.6	8.5	8.6	16.6
COGS		91.3	3.1	62.1	38.8	6.2	6.5	18.3
Depreciation		75.5	0.0	119.5	54.9	0.0	0.0	5.8
Material cost		156.8	(1.9)	75.1	24.7	8.5	8.6	16.6
Labor cost, etc.		47.5	11.4	19.4	49.6	8.5	8.6	30.2
SG&A		16.4	(0.4)	57.1	23.2	(5.3)	4.0	8.4
Labor cost		114.0	(1.9)	75.1	103.1	8.5	8.6	(14.0)
Marketing fee		(0.5)	0.1	50.6	3.8	(14.9)	0.0	13.2
Others		114.0	(1.9)	75.1	49.6	8.5	8.6	16.6
OP		(40.8)	16.9	(0.4)	(92.4)	(992.5)	57.9	40.3

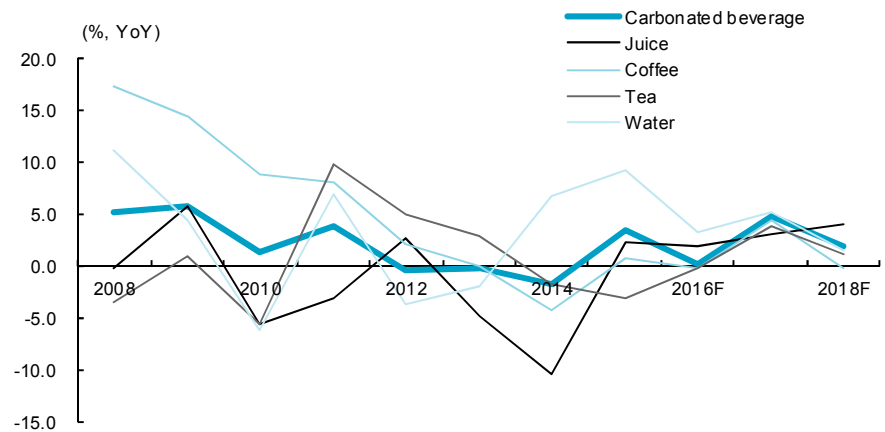
Source: Korea Investment &amp; Securities

**Figure 1. Sales and NP at Pepsi-Cola Products Philippines**


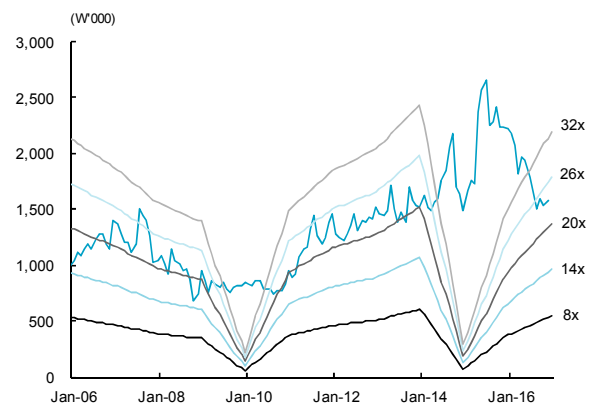
Source: Lotte Chilsung, Korea Investment &amp; Securities

**Figure 2. Sales and NP at Lotte-MGS Beverage (Myanmar)**


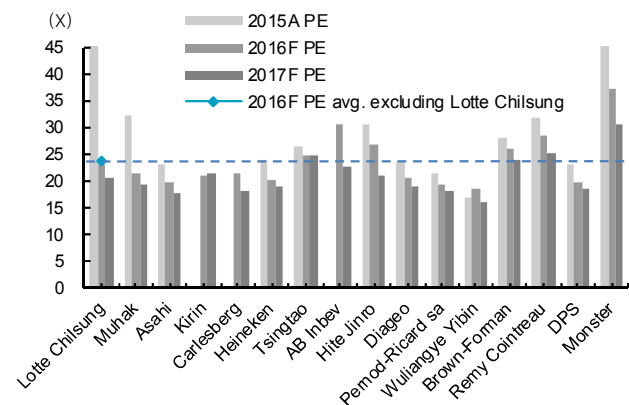
Source: Lotte Chilsung, Korea Investment &amp; Securities

**Figure 3. Domestic beverage ASP growth**


Source: Lotte Chilsung, Korea Investment &amp; Securities

**Figure 4. Adjusted PE band**


Source: Quantwise, Korea Investment &amp; Securities

**Figure 5. Comparison PE with global peers**


Source: Bloomberg, Korea Investment &amp; Securities

**Company overview & Glossary**

Lotte Chilsung Beverage is a comprehensive beverages company that makes carbonated drinks and juices as well as alcoholic drinks such as soju. Its flagship product is Chilsung Cider, a lemon-lime soft drink. Other drinks include Let's Be (canned coffee) and Cheoeum Cheoreom (soju). Lotte Chilsung is the no. 1 player in the domestic beverage industry and boasts the strongest brand power. Its subsidiaries include CH Beverage and Chung-Buk Soju. The company also has a presence in Southeast Asia with a 38.9% stake in Pepsi-Cola Products Philippines, Inc.

### Balance sheet

FY-ending Dec. (W bn)	2014A	2015A	2016F	2017F	2018F
Current assets	832	955	1,016	1,014	1,081
Cash & cash equivalent	108	203	238	205	277
Accounts & other receivables	245	246	250	256	263
Inventory	262	241	245	256	222
Non-current assets	3,268	3,427	3,734	4,081	4,019
Investment assets	825	885	933	1,030	956
Tangible assets	1,854	1,988	2,226	2,434	2,395
Intangible assets	411	378	391	421	455
Total assets	4,100	4,382	4,750	5,095	5,099
Current liabilities	1,012	837	881	921	977
Accounts & other payables	477	511	529	569	616
ST debt & bond	105	179	199	199	199
Current portion of LT debt	420	106	106	106	106
Non-current liabilities	771	1,182	1,448	1,677	1,511
Debentures	382	744	959	1,109	909
LT debt & financial liabilities	71	119	158	158	158
Total liabilities	1,783	2,019	2,329	2,599	2,488
Controlling interest	2,274	2,336	2,393	2,466	2,578
Capital stock	7	7	7	7	7
Capital surplus	21	21	21	21	21
Other Reserves	(35)	(42)	(42)	(42)	(42)
Retained earnings	1,878	1,964	2,043	2,133	2,259
Minority interest	43	26	28	30	33
Shareholders' equity	2,317	2,363	2,421	2,497	2,611

### Cash flow

FY-ending Dec. (W bn)	2014A	2015A	2016F	2017F	2018F
C/F from operating	145	275	281	408	467
Net profit	21	100	94	106	143
Depreciation	100	110	139	179	196
Amortization	23	23	23	25	27
Net incr. in W/C	(45)	5	28	102	111
Others	46	37	(3)	(4)	(10)
C/F from investing	(387)	(329)	(505)	(576)	(178)
CAPEX	(294)	(259)	(377)	(387)	(158)
Decr. in fixed assets	6	5	0	0	0
Incr. in investment	(105)	(68)	(65)	(105)	76
Net incr. in intangible assets	(1)	(0)	(37)	(55)	(61)
Others	7	(7)	(26)	(29)	(35)
C/F from financing	231	149	259	134	(217)
Incr. in equity	0	0	0	0	0
Incr. in debts	252	154	274	150	(200)
Dividends	(6)	(8)	(12)	(13)	(13)
Others	(15)	3	(3)	(3)	(4)
C/F from others	(1)	(0)	0	0	0
Increase in cash	(12)	95	35	(33)	72

Note: Based on K-IFRS (consolidated)

### Income statement

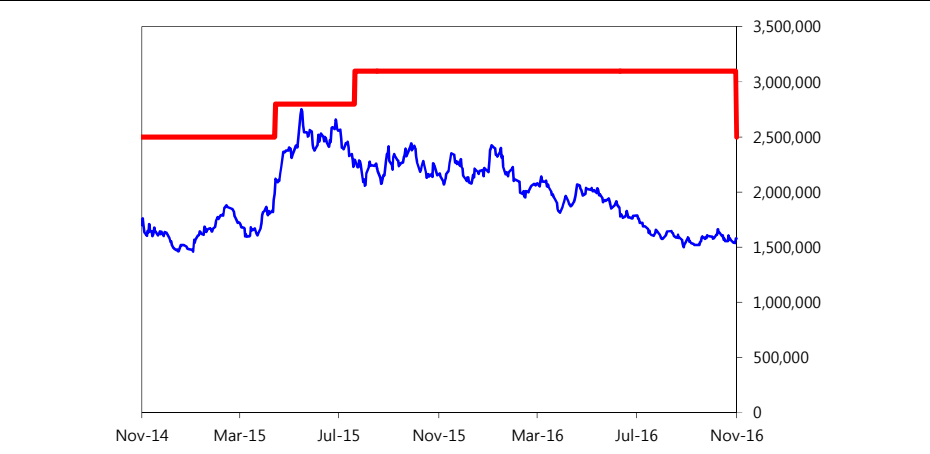
FY-ending Dec. (W bn)	2014A	2015A	2016F	2017F	2018F
Sales	2,184	2,299	2,380	2,561	2,771
COGS	1,271	1,318	1,350	1,429	1,518
Gross profit	913	981	1,031	1,132	1,252
SG&A expense	820	838	868	944	1,019
Operating profit	93	143	163	188	234
Financial income	14	17	17	18	18
Interest income	3	4	4	4	5
Financial expense	56	35	37	42	41
Interest expense	28	25	27	31	31
Other non-operating profit	(19)	(25)	(18)	(26)	(28)
Gains (Losses) in associates, subsidiaries and JV	0	(1)	6	9	15
Earnings before tax	32	98	130	147	198
Income taxes	19	37	36	41	55
Net profit	21	100	94	106	143
Net profit of controlling interest	19	100	92	104	140
Other comprehensive profit	(155)	(28)	(22)	(18)	(14)
Total comprehensive profit	(134)	73	72	88	128
Total comprehensive profit of controlling interest	(135)	76	70	87	126
EBITDA	216	276	325	392	457

### Key financial data

FY-ending Dec.	2014A	2015A	2016F	2017F	2018F
per share data (KRW)					
EPS	13,754	73,389	67,725	76,555	102,905
BPS	1,675,276	1,721,282	1,763,387	1,817,279	1,899,570
DPS	4,900	9,200	9,400	9,600	10,000
Growth (%)					
Sales growth	(1.4)	5.3	3.5	7.6	8.2
OP growth	(46.1)	53.6	14.1	15.4	24.1
NP growth	(81.5)	433.3	(7.7)	13.0	34.4
EPS growth	(81.5)	433.6	(7.7)	13.0	34.4
EBITDA growth	(23.1)	28.1	17.8	20.7	16.5
Profitability (%)					
OP margin	4.3	6.2	6.8	7.3	8.4
NP margin	0.9	4.3	3.9	4.1	5.0
EBITDA margin	9.9	12.0	13.7	15.3	16.5
ROA	0.5	2.4	2.1	2.2	2.8
ROE	0.8	4.3	3.9	4.3	5.5
Dividend yield	0.3	0.4	0.6	0.6	0.7
Dividend payout ratio	35.6	12.5	13.9	12.5	9.7
Stability					
Net debt (W bn)	723	752	971	1,128	837
Int.-bearing debt/equity (%)	42.2	48.6	58.8	62.6	52.2
Valuation (X)					
PE	108.0	30.2	22.7	20.1	14.9
PB	0.9	1.3	0.9	0.8	0.8
EV/EBITDA	12.4	13.2	9.2	8.0	6.3

Changes to recommendation and price target

Company (Code)	Date	Recommendation	Price target
Lotte Chilsung Beverage (005300)	11-12-14	BUY	W2,500,000
	04-17-15	BUY	W2,800,000
	07-24-15	BUY	W3,100,000
	11-04-16	BUY	W2,500,000



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BUY	Hold	Underweight (Sell)
81.1%	17.6%	1.3%

Note: % of companies under coverage with this rating

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Prepared by: Kyoung Ju Lee



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