

NAVER (035420)

Above
In line
Below

12M rating **BUY (Maintain)**

12M TP **W900,000** from W900,000

Up/downside **+28%**

Stock Data

KOSPI (May 8, pt)	1,951
Stock price (May 8, KRW)	705,000
Market cap (USD mn)	22,725
Shares outstanding (mn)	33
52-Week high/low (KRW)	853,000/269,500
6M avg. daily turnover (USD mn)	122.8
Free float / Foreign ownership (%)	81.3/55.2
Major shareholders (%)	
Hae-Jin Lee and 10 others	9.1
National Pension Service (NPS)	8.0

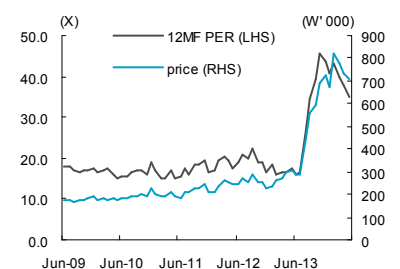
Valuation

	2013A	2014F	2015F
PE (x)	14.4	36.5	28.5
PB (x)	11.3	8.8	7.0
ROE (%)	112.7	33.0	31.4
EV/EBITDA (x)	34.4	22.7	18.2
EPS (KRW)	50,227	19,289	24,751
BPS (KRW)	64,165	80,434	101,332

Performance

	1M	6M	12M
Absolute (%)	(5.0)	25.9	136.2
Relative to KOSPI (%p)	(2.9)	27.6	136.5

12MF PE trend



Source: WISEfn consensus

Robust LINE growth to differentiate NAVER

What's new: 1Q14 OP above consensus on lower marketing expenses

1Q14 sales surged 23.9% YoY to W638.0bn, in line with our estimate. However, OP came in at W189.9bn (18% above OP consensus of W160.7bn), beating our estimate by 8%. Marketing expenses dropped 49% QoQ to W41.7bn, 52% below our outlook (W63.3bn). LINE sales reached W145.2bn, up 6% QoQ. Games, sticker and ads & others accounted for 60%, 15% and 25% of gross sales, respectively. As for regional sales breakdown, Japan accounted for 80% and others 20% of sales. According to the company, it deferred W8.6bn (JPY800mn) in sales of items with unlimited usage, such as stickers, and the Line Free Coin application pro rata to unused value to reflect accounting practice changes.

Pros: Rapid LINE subscriber and sales growth to continue

LINE subscribers grew 100mn YTD to 420mn as of April. LINE sales grew 15.8% QoQ, excluding FX effects. Due to changes in accounting practice, W12.8bn was added to 4Q13 LINE sales but W8.6bn was deferred. As such, KRW-based actual growth should be higher at 23.9%. 2Q14 LINE sales should increase 12% QoQ thanks to the success of Cookie Run in Taiwan and Thailand (leader in terms of gross sales) and LINE Rangers, which has a relatively higher margin as the game was developed by LINE Plus, a subsidiary.

Cons: Decrease in other sales

1Q14 other sales (IT service and real estate) dropped 34% QoQ due to changes in real estate service policy and a weak JPY. Naver stopped sales of real estate-related proprietary goods (properties for sale) in May and, as such, we expect 2Q14 other sales to drop 25% QoQ.

Robust LINE growth to differentiate Naver from global SNS peers

We maintain BUY and our TP of W900,000 (SotP; sum of W17tn LINE value and W10tn portal value divided by total shares outstanding). 1) LINE continues to post robust growth and a diversified business model should catalyze sales growth. 2) Diverse services through its mobile platform should bolster business model and the continued success of LINE should differentiate Naver's share price from global SNS peers. 3) Closed-SNS service BAND should gain on increased global users and mobile game releases.

(W bn, %, %p)

	1Q14P				Change		2014F	
	KIS est.	Actual	Diff.	Consensus	QoQ	YoY	KIS	Consensus
Sales	638.0	638.0	0.0	640.3	(0.5)	23.9	2,724.7	2,794.0
OP	175.2	189.8	8.3	160.7	23.0	50.5	790.8	761.5
OP margin	27.5	29.8	2.3	25.1	NM	NM	29.0	27.3
EBT	188.9	189.4	0.2	172.4	309.9	37.4	803.4	782.3
NP	141.7	128.9	(9.0)	132.4	178.2	17.5	574.1	583.5

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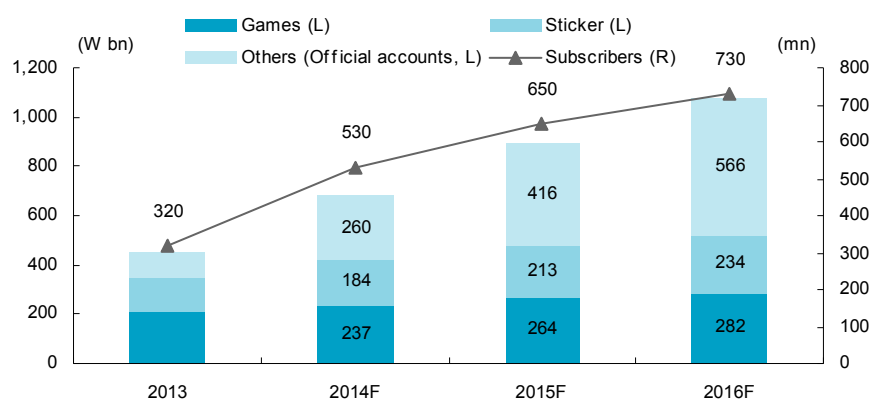
Table 1. Quarterly earnings and forecast

(W bn, %, %p)

	3Q13	4Q13	1Q14P	QoQ	YoY	KIS	Diff. Consensus	Diff.	2Q14F	3Q14F	
Sales	585.3	641.1	638.0	(0.5%)	23.9%	638.0	0.0%	640.3	(0.4%)	673.6	683.3
Ads	427.2	478.7	477.1	(0.3%)	15.5%	355.6	34.2%		511.4	508.5	
Content	117.9	117.8	131.5	11.6%	92.8%	81.7	60.8%		140.1	153.6	
Others	40.3	44.6	29.5	(34.0%)	(13.3%)	56.5	(47.8%)		22.2	21.2	
SG&A	480.8	486.8	448.2	(7.9%)	15.2%	462.8	(3.1%)		478.5	487.7	
Labor cost	117.9	134.1	135.3	1.0%	13.6%	128.6	5.2%		140.3	141.9	
Commission	165.4	170.8	167.1	(2.2%)	13.0%	165.7	0.9%		173.9	176.9	
Marketing	94.4	81.8	41.7	(49.0%)	32.3%	63.3	(34.2%)		57.0	57.7	
Depreciation	32.2	33.7	34.0	0.8%	25.9%	34.4	(1.2%)		34.7	35.4	
Communication	30.1	30.6	27.5	(10.3%)	(3.6%)	32.6	(15.8%)		29.5	31.5	
Employee benefits	14.5	13.7	16.3	18.5%	13.9%	15.5	4.6%		15.8	16.1	
Others	26.1	22.0	26.4	19.8%	27.5%	22.6	16.8%		27.4	28.2	
Operating profit	104.5	154.3	189.8	23.0%	50.5%	175.2	8.3%	160.7	18.1%	195.2	195.6
OP margin	17.9%	24.1%	29.8%	5.7%p	5.3%p	27.5%	2.3%p	25.1%	4.7%p	29.0%	28.6%
EBT	131.3	46.2	189.4	309.9%	37.4%	189.4	(0.0%)	172.4	9.9%	209.2	209.6
Tax	55.0	-0.2	60.4	-	114.8%	47.4	27.6%		57.5	57.6	
NP from continued business	76.2	46.4	128.9	178.2%	17.5%	142.1	(9.2%)	132.4	(2.6%)	151.6	152.0
NP from discontinued business	1,485.0	7.8									
NP	1,561.2	54.1									

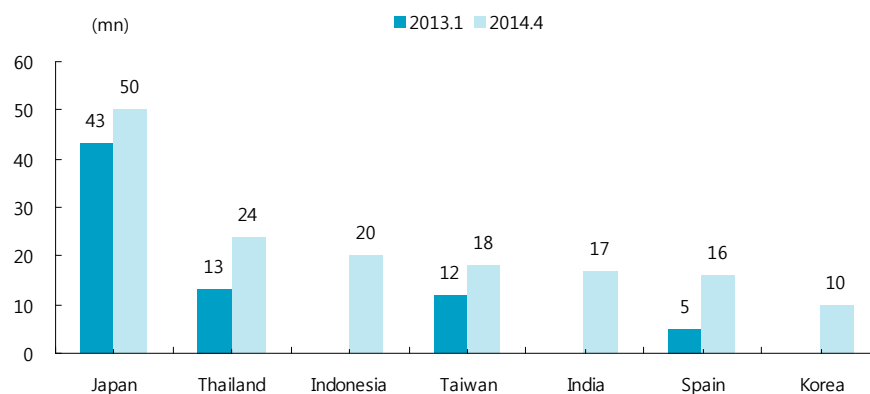
Source: Company data, Korea Investment & Securities

Figure 1. Line subscribers and sales by business



Source: Company data, Korea Investment & Securities

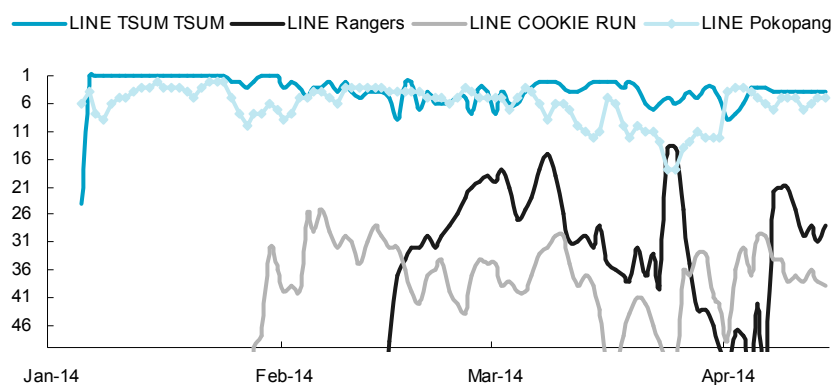
Figure 2. Line subscribers by region



Source: Company data, Korea Investment & Securities

Table 2. Major LINE game line-up

1Q13	2Q13	3Q13	4Q13	1Q14	2Q14
Birzzle Friends (Jan-10)	GoGo! TwinBee (May-20)	ELGARD (Jul-09)	Nutlings Tournament (Oct-25)	LINE GOIGOIGO! (Jan-17)	LINE Shake Spears! (May-2)
HIDDEN CATCH (Feb-04)	Air Penguin Friends (Apr-04)	Fluffy Diver (Jul-10)	Fly! ANIMAL (Oct-29)	LINE Party Run (Jan-22)	
WIND Runner (Feb-19)	Punch Hero (Apr-16)	DROP Spirit Catcher (Jul-11)	Dozer (Nov-21)	LINE Sonic Dash S (Jan-29)	
Dragon Flight (Mar-05)	JELLY (Apr-19)	QUIZ (Jul-16)	Fish Island (Nov-22)	Disney TSUM TSUM (Jan-29)	
Theater Play town (Mar-05)	I Love Coffee (Apr-25)	PongPongPong (Aug-19)	RUNRUN HERO (Nov-29)	Cookie Run (Jan-30)	
EASY DIVER (Mar-13)	Ninja Strikers (Apr-25)	MapleStory Village (Sep-12)	Puzzle Bobble (Dec-10)	LINE Dream Garden (Feb-12)	
MASS FISHING (Mar-14)	Mucus (May-28)		PakuPaku Battle (Dec-12)	LINE 童話のパティスリー (Feb-21)	
Tiny Farm (Mar-21)	Pokopang (May-28)		DashGirl (Dec-24)	LINE Rangers (Feb-28)	
	Dellooone (May-29)		Puzzle Inazuma Eleven (Dec-24)	LINE ワニワニパニック ライ ンハンターズ (Mar-27)	
	TOUR (May-31)		Let's Golf! (Dec-26)		
	Neko Jump (Jun-11)				
	Touch Touch (Jun-11)				

Source: <http://linegameblog.jp/>, Korea Investment & Securities**Figure 3. Line major games sales ranking in App store in Japan**

Source: App Annie

Table 3. Global peer valuations

	Country	Company	14F PE	15F PE
Internet portals	US	Google	19.1	16.2
		Yahoo!	21.1	18.4
		Average	20.1	17.3
	Japan	Yahoo! Japan	19.1	16.8
	China	Baidu	27.7	19.6
Sina Corp.		31.6	19.5	
Average		29.6	19.6	
SNS providers	US	Facebook	40.2	31.5
		LinkedIn	86.9	56.9
		Groupon	50.8	20.5
		Average	59.3	36.3

Source: Bloomberg

Table 6. Annual earnings and forecast

(W bn, %, %p)

	2013A	2014F	YoY	2015F	YoY
Sales	2,312.0	2,724.7	17.9%	3,093.3	13.5%
Ads	1,745.4	2,045.6	17.2%	2,276.4	11.3%
Content	417.4	586.0	40.4%	734.1	25.3%
Others	149.2	93.1	(37.6%)	82.8	(11.0%)
SG&A	1,787.8	1,933.9	8.2%	2,108.8	9.0%
Labor cost	492.7	575.0	16.7%	617.8	7.4%
Commission	661.6	706.3	6.8%	784.9	11.1%
Marketing	247.2	214.6	(13.2%)	209.6	(2.3%)
Depreciation	121.4	140.4	15.6%	151.5	7.9%
Communication	119.3	121.9	2.1%	153.9	26.3%
Employee benefits	56.5	64.3	13.7%	70.0	8.9%
Others	89.1	111.4	25.1%	121.1	8.7%
OP	524.1	790.8	50.9%	984.5	24.5%
<i>OP margin</i>	22.7%	29.0%	6.4%p	31.8%	2.8%p
EBT	456.9	803.4	75.8%	1,016.0	26.5%
Tax	131.1	229.3	74.9%	279.4	21.9%
NP from continued business	325.8	574.1	76.2%	736.6	28.3%
NP from discontinued business	1,569.5				
NP	1,895.3	574.1	(69.7%)	736.6	28.3%

Source: Company data, Korea Investment & Securities

Table 7. 2014~2015F earnings revision

(W bn, %, %p)

	2014F			2015F		
	Previous	Revised	Chg.	Previous	Revised	Chg.
Sales	2,714.0	2,724.7	0.4	3,110.2	3,093.3	(0.5)
OPEX	1,933.0	1,933.9	0.0	2,077.4	2,108.8	1.5
OP	781.0	790.8	1.3	1,032.8	984.5	(4.7)
<i>OP margin</i>	28.8	29.0	0.2%p	33.2	31.8	(1.4%p)
EBT	806.5	803.4	(0.4)	1,060.3	1,016.0	(4.2)
NP	604.9	574.1	(5.1)	795.2	736.6	(7.4)

Source: Korea Investment & Securities

Company overview & Glossary

Naver, formerly NHN, was established in 1999 and initially provided Internet search portal and online gaming services. In August 2013, NHN was renamed Naver after its gaming business was spun off into a new entity, which relisted as NHN Entertainment (181710). Naver's main services include search and display ads as well as the mobile instant messaging service Line. Naver is Korea's largest search portal that generated search ad sales of W180.3bn and display ad sales of W35bn in 2012 (consolidated). Line launched in June 2011 has more than 340mn users worldwide as of February 2014 and is emerging as a globally-recognized mobile instant messaging service.

- Mobile instant messaging service: A platform that provides text messaging, photo sharing and voice calling services; Mobile instant messaging services have expanded with the introduction of smartphones; While KakaoTalk holds the biggest market share in Korea, various mobile messengers such as Line, WeChat and WhatsApp are competing in the global market
- Stamps: Virtual images depicting well-known cartoon characters or celebrities that can be downloaded and shared between mobile messenger users

Balance sheet

FY-ending Dec. (W bn)	2012A	2013A	2014F	2015F	2016F
Current assets	1,739	1,336	1,891	2,631	3,468
Cash & cash equivalent	395	435	926	1,609	2,395
Accounts & other receivables	274	326	384	436	482
Inventory	0	0	0	0	0
Non-current assets	1,188	1,362	1,516	1,620	1,730
Investment assets	376	261	305	309	325
Tangible assets	566	792	842	892	942
Intangible assets	122	134	158	179	198
Total assets	2,927	2,698	3,407	4,250	5,198
Current liabilities	645	832	975	1,120	1,259
Accounts & other payables	320	363	409	464	513
ST debt & bond	3	86	169	252	335
Current portion of LT debt	133	156	156	156	156
Non-current liabilities	378	390	421	432	432
Debentures	0	110	110	110	110
LT debt & financial liabilities	195	0	0	0	0
Total liabilities	1,024	1,222	1,396	1,551	1,691
Controlling interest	1,896	1,471	2,008	2,696	3,505
Capital stock	24	16	16	16	16
Capital surplus	196	133	133	133	133
Capital adjustments	(953)	(3,115)	(3,115)	(3,115)	(3,115)
Retained earnings	2,668	4,556	5,092	5,781	6,590
Minority interest	7	4	3	2	1
Shareholders' equity	1,904	1,475	2,011	2,699	3,507

Cash flow

FY-ending Dec. (W bn)	2012A	2013A	2014F	2015F	2016F
C/F from operating	596	628	732	897	1,029
Net profit	544	1,895	574	737	865
Depreciation	89	116	139	147	156
Amortization	18	16	21	23	26
Net incr. in W/C	(95)	71	(31)	(19)	(15)
Others	40	(1,470)	29	9	(3)
C/F from investing	(690)	(423)	(286)	(250)	(270)
CAPEX	(280)	(380)	(189)	(197)	(206)
Decr. in fixed assets	3	18	0	0	0
Incr. in investment	(393)	(46)	(44)	(4)	(16)
Net incr. in intangible assets	(29)	(40)	(44)	(45)	(45)
Others	9	25	(9)	(4)	(3)
C/F from financing	24	(162)	45	35	27
Incr. in equity	14	1	0	0	0
Incr. in debts	151	71	83	83	83
Dividends	(24)	(27)	(22)	(38)	(49)
Others	(117)	(207)	(16)	(10)	(7)
C/F from others	(0)	(3)	0	0	0
Increase in cash	(71)	40	491	682	786

Note: Based on K-IFRS (consolidated)

Income statement

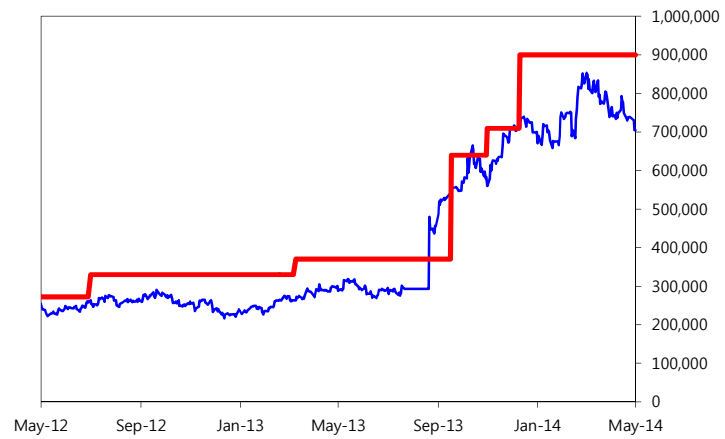
FY-ending Dec. (W bn)	2012A	2013A	2014F	2015F	2016F
Sales	1,799	2,312	2,725	3,093	3,421
COGS	0	0	0	0	0
Gross profit	1,799	2,312	2,725	3,093	3,421
SG&A expense	1,277	1,788	1,934	2,109	2,260
Operating profit	521	524	791	985	1,162
Financial income	73	78	73	90	90
Interest income	27	22	37	54	76
Financial expense	10	13	20	14	14
Interest expense	7	7	14	17	20
Other non-operating profit	(36)	(129)	(40)	(45)	(45)
Gains (Losses) in associates, subsidiaries and JV	0	(2)	(0)	0	0
Earnings before tax	549	457	803	1,016	1,193
Income taxes	148	131	229	279	328
Net profit	544	1,895	574	737	865
Net profit of controlling interest	546	1,897	575	737	866
Other comprehensive profit	(92)	(64)	0	0	0
Total comprehensive profit	452	1,832	574	737	865
Total comprehensive profit of controlling interest	454	1,834	575	737	866
EBITDA	628	656	950	1,155	1,343

Key financial data

FY-ending Dec.	2012A	2013A	2014F	2015F	2016F
per share data (KRW)					
EPS	12,422	50,227	19,289	24,751	29,062
BPS	58,637	64,165	80,434	101,332	125,872
DPS	616	734	1,291	1,632	1,914
Growth (%)					
Sales growth	(15.2)	28.5	17.9	13.5	10.6
OP growth	(21.1)	0.6	50.9	24.5	18.0
NP growth	21.4	247.5	(69.7)	28.3	17.4
EPS growth	22.6	304.3	(61.6)	28.3	17.4
EBITDA growth	(16.1)	4.4	44.9	21.6	16.3
Profitability (%)					
OP margin	29.0	22.7	29.0	31.8	34.0
NP margin	30.4	82.1	21.1	23.8	25.3
EBITDA margin	34.9	28.4	34.9	37.3	39.3
ROA	20.5	67.4	18.8	19.2	18.3
ROE	31.4	112.7	33.0	31.4	27.9
Dividend yield	0.3	0.1	0.2	0.2	0.3
Stability					
Net debt (W bn)	(1,060)	(626)	(1,034)	(1,632)	(2,336)
Debt/equity ratio (%)	17.3	23.8	21.6	19.2	17.1
Valuation (X)					
PE	18.1	14.4	36.5	28.5	24.3
PB	3.8	11.3	8.8	7.0	5.6
PS	6.0	13.1	8.5	7.5	6.8
EV/EBITDA	14.2	34.4	22.7	18.2	15.1

Changes to recommendation and price target

Company (Code)	Date	Recommendation	Price target
NAVER (035420)	05-11-12	BUY	W273,000
	07-09-12	BUY	W330,000
	03-18-13	BUY	W370,000
	09-25-13	BUY	W640,000
	11-08-13	BUY	W710,000
	12-18-13	BUY	W900,000



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- 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.

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- 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.

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Prepared by: Jonggil Hong

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