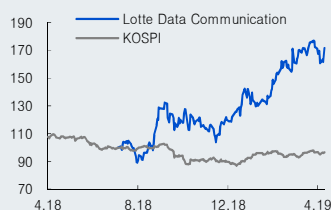


(Maintain)	Buy
Target Price (12M, W)	63,000
Share Price (05/02/19, W)	49,750
Expected Return	27%

OP (19F, Wbn)	45
Consensus OP (19F, Wbn)	46
EPS Growth (19F, %)	10.6
Market EPS Growth (19F, %)	-17.0
P/E (19F, x)	20.4
Market P/E (19F, x)	12.0
KOSPI	2,212.75

Market Cap (Wbn)	711
Shares Outstanding (mn)	14
Free Float (%)	24.0
Foreign Ownership (%)	1.9
Beta (12M)	0.17
52-Week Low	25,850
52-Week High	51,300

(%)	1M	6M	12M
Absolute	0.6	38.6	0.0
Relative	-1.0	31.3	0.0



Mirae Asset Daewoo Co., Ltd.

[Analyst]

Dae-ro Jeong
+822-3774-1634
daero.jeong@miraeasset.com

Lotte Data Communication

(286940 KS)

HIT merger to create additional business opportunities

1Q19 review: Consolidated OP falls 2.9% YoY to W5.6bn

For 1Q19, Lotte Data Communication announced consolidated revenue of W186.5bn (+1.4% YoY), operating profit of W5.6bn (-2.9% YoY), and net profit attributable to controlling interests of W4.9bn (-9.4% YoY).

The YoY decline in operating profit was mainly due to the company's consolidated subsidiary, Hyundai Information Technology (HIT), which suffered wider operating losses on weaker revenue and data center depreciation expenses (W4.5bn). On a non-consolidated basis, revenue and operating profit grew to W161.5bn (+5.7% YoY) and W8.7bn (+13% YoY), respectively. Despite unfavorable seasonality, we believe the company performed well, aided by revenue growth from the addition of affiliates (including Lotte Chemical), and higher labor pricing.

HIT merger to strengthen competitiveness and create various opportunities

On April 10th, Lotte Data Communication's board approved a resolution to merge HIT (59.7% stake) into the company. The merger ratio has been set at 1:0.0462799 for Lotte Data Communication (surviving entity): HIT (merging entity). As part of the merger, the company will issue new shares equal to 7.8% of its total shares outstanding. Because the deal is, by law, a small-scale merger, the board's approval will substitute for shareholders' consent. No appraisal rights will be offered.

As HIT was already a consolidated subsidiary, the merger is unlikely to cause any material changes in the company's financial statements. However, we view the deal as positive from a business efficiency and competitiveness perspective, as: 1) we believe the merger will allow the company to improve its cost competitiveness by saving administrative expenses and enhance efficiency through better human and physical resource management; 2) by internalizing HIT's competitive strength in SOC projects (railway, airports, ports, etc.), the company is likely to capture related business opportunities in non-affiliate and overseas markets; and 3) we also expect data-based businesses, like cloud and big data, to gather momentum, fueled by the integration of data center/IT infrastructure operating capabilities.

Currently, a fourth data center dedicated to cloud (5,000m², W49.5bn invested) is being built in Yongin, Gyeonggi Province, with construction due to be completed in December 2020. With data center demand expected to grow alongside the proliferation of cloud services, we expect the company to expand its cloud business and earnings by leveraging its experience in operating affiliates' cloud systems at its existing data centers (Seoul, Daejeon, and Yongin) and strengthening its partnerships with global companies like Amazon Web Services (AWS), Microsoft, Oracle, and IBM.

Maintain Buy and TP of W63,000; biggest beneficiary of Lotte Group's IT spending

We maintain our Buy call and target price of W63,000 on Lotte Data Communication. The stock is currently trading at a 2019F P/E of 20.4x. As the only IT services firm under Lotte Group's umbrella, Lotte Data Communication should deliver steady revenue growth of more than 10% annually through 2025, backed by the group's aggressive IT spending.

Lotte Group is pursuing a digital transformation to identify new growth opportunities, with plans to invest W50tr in its domestic and overseas businesses over the next five years. Among the group's investment plans, Lotte Data Communication will likely take charge of most IT infrastructure projects (smart factories, smart logistics systems, etc.), which should drive continued earnings improvements.

FY (12)	12/15	12/16	12/17	12/18	12/19F	12/20F
Revenue (Wbn)	0	0	149	812	910	1,016
OP (Wbn)	0	0	5	39	45	54
OP margin (%)	-	-	3.4	4.8	4.9	5.3
NP (Wbn)	0	0	2	26	35	39
EPS (W)	0	0	1,139	2,205	2,439	2,702
ROE (%)	0.0	0.0	1.0	9.6	9.6	9.9
P/E (x)	-	-	-	16.1	20.4	18.4
P/B (x)	-	-	-	1.4	1.9	1.8
Dividend yield (%)	-	-	-	1.8	1.3	1.3

Note: All figures are based on consolidated K-IFRS; NP refers to net profit attributable to controlling interests

Source: Company data, Mirae Asset Daewoo Research estimates

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Table 1. Quarterly and annual earnings breakdown

(Wbn, %)

	1Q18	2Q18	3Q18	4Q18	1Q19	2Q19F	3Q19F	4Q19F	2015	2016	2017	2018	2019F	2020F
Revenue	183.9	200.0	192.1	235.7	186.5	229.0	217.3	277.0	734.9	768.8	819.7	811.7	909.7	1,015.7
SM	41.1	42.8	45.2	48.8	46.1	50.9	51.2	58.7	127.0	138.1	151.1	177.9	207.0	225.2
SI	142.8	157.2	146.9	186.9	140.4	178.1	166.0	218.2	607.9	630.7	668.6	633.8	702.7	790.5
Revenue breakdown	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
SM	22.3%	21.4%	23.5%	20.7%	24.7%	22.2%	23.6%	21.2%	17.3%	18.0%	18.4%	21.9%	22.8%	22.2%
SI	77.7%	78.6%	76.5%	79.3%	75.3%	77.8%	76.4%	78.8%	82.7%	82.0%	81.6%	78.1%	77.2%	77.8%
Operating profit	5.8	9.0	7.3	16.8	5.6	11.1	9.9	18.4	29.0	18.9	34.2	39.0	45.0	53.6
OP margin	3.2	4.5	3.8	7.1	3.0	4.8	4.6	6.6	3.9	2.5	4.2	4.8	5.0	5.3
SM	4.1	3.8	4.4	6.5	4.9	4.8	5.3	7.1	11.5	12.7	14.1	18.8	22.1	24.3
OP margin	10.0	8.9	9.7	13.3	10.7	9.4	10.3	12.0	9.1	9.2	9.4	10.6	10.7	10.8
SI	1.7	5.2	2.9	10.3	0.7	6.3	4.7	11.3	17.4	6.2	20.1	20.2	23.0	29.3
OP margin	1.2	3.3	2.0	5.5	0.5	3.5	2.8	5.2	2.9	1.0	3.0	3.2	3.3	3.7
Pretax profit	6.7	8.9	7.3	11.7	5.8	11.0	9.9	19.3	23.7	15.1	27.6	34.6	45.9	55.1
Net profit	4.5	6.3	4.4	8.2	3.3	7.7	6.9	13.5	16.9	11.9	20.6	23.4	31.5	38.8
Net profit (controlling)	5.4	6.6	4.7	9.6	4.9	8.1	7.4	14.4	16.9	11.9	20.8	26.3	34.8	38.6
YoY growth														
Revenue					1.4	14.5	13.1	17.5	2.4	4.6	6.6	-1.0	12.1	11.6
Security systems services					12.2	19.0	13.3	20.4	4.7	8.7	9.4	17.7	16.4	8.8
Building management					-1.7	13.3	13.0	16.7	1.9	3.8	6.0	-5.2	10.9	12.5
Call center & telemarketing					-2.9	22.5	35.3	9.6	2.1	-34.7	80.7	14.0	15.5	19.0
Operating profit					20.0	26.4	20.0	8.7	8.1	10.3	11.2	32.9	17.4	10.3
Security systems					-58.1	19.7	58.1	9.8	-1.5	-64.4	223.4	0.7	13.7	27.4
Building management					-13.4	23.1	35.5	64.9	1.0	-36.3	82.8	25.4	32.8	20.0
Call center & telemarketing					-26.3	23.1	58.2	64.5	1.0	-29.6	73.1	13.4	34.7	23.1
Pretax profit					-9.4	23.1	58.2	49.7	1.0	-29.6	74.8	26.5	32.4	10.8

Source: Company data, Mirae Asset Daewoo Research

Table 1. Parent-based earnings of Lotte Data Communication and HIT

Lotte Data Communication (286940)

(Wbn)

	2017	1Q18	2Q18	3Q18	4Q18	2018	1Q19	QoQ	YoY	Notes
Revenue	568.1	152.9	176.1	160.8	201.5	691.2	161.5	-19.8	5.7	1Q19 revenue and operating profit improved 5.7% and 13.0%, respectively
Cost of sales	522.0	139.4	159.5	146.3	179.9	625.1	146.7	-18.4	5.3	
Gross profit	46.1	13.5	16.6	14.5	21.6	66.2	14.8	-31.5	9.8	SM revenue improved on the addition of new affiliates
SG&A expenses	18.8	5.7	6.8	6.8	4.6	23.9	6.1	31.1	6.4	
Loss provisions	0.0	0.1	-0.1	0.0	1.4	1.4	0.1	-93.3	-22.6	Margins improved on labor cost hikes for SM services
Operating profit	27.3	7.7	9.9	7.7	15.6	40.8	8.7	-44.4	13.0	
Pretax profit	55.1	9.2	10.1	8.3	15.5	43.0	9.8	-36.7	6.4	
Income Tax	30.9	2.3	2.7	3.0	3.6	11.6	2.4	-34.5	4.6	
Net profit	24.2	6.9	7.3	5.3	11.9	31.4	7.4	-37.4	7.0	

HIT (026180)

(Wbn)

	2017	1Q18	2Q18	3Q18	4Q18	2018	1Q19	QoQ	YoY	Notes
Revenue	157.4	34.4	37.0	34.6	43.7	149.7	30.3	-30.7	-12.0	In 1Q19, revenue declined 12% YoY and operating loss expanded
Cost of sales	150.2	34.8	36.3	33.5	40.7	145.2	32.1	-21.0	-7.7	
Gross profit	7.2	-0.4	0.7	1.1	3.1	4.5	-1.8	RR	RR	
SG&A expenses	4.3	0.9	0.9	0.9	1.0	3.8	1.0	6.8	13.0	
Operating Profit	3.0	-1.3	-0.3	0.2	2.1	0.7	-2.9	TTR	RR	Data center depreciation of W4.5bn and the absence of rental income (W0.6bn per quarter)
Pretax profit	1.1	-1.9	-0.7	-0.4	-3.2	-6.2	-3.9	RR	RR	
Income tax	0.1	0.0	0.0	0.0	0.0	0.0	0.0	-	-	
Net profit	1.0	-1.9	-0.7	-0.4	-3.2	-6.2	-3.9	RR	RR	
Net profit (controlling)	1.0	-1.9	-0.7	-0.4	-3.2	-6.2	-3.9	RR	RR	

Source: DART, Mirae Asset Daewoo Research

Table 2. Lotte Data Communication and HIT merger schedule

	Lotte Data Communication (merging)	HIT (merged)
BOD resolution	April 10, 2019	
Merger contract	April 11, 2019	
Confirmation of shareholders list	April 25, 2019	
General shareholders' meeting	For a small-scale merger, the BOD's approval substitutes resolution at general shareholders' meeting No appraisal rights will be offered	May 30, 2019
Exercising of appraisal rights by dissenting shareholders		May 31-June 20, 2019
Appraisal rights exercise price		₩2,209
Reporting objection to merger	April 25-May 9, 2019	
Merger date	July 1, 2019	
Distribution of stock certificates	July 16, 2019	
Listing of new shares	July 17, 2019	

Source: DART, Mirae Asset Daewoo Research

Table 3. Merger price and ratio

	Lotte Data Communication (merging)	HIT (merged)
Merger price (₩)	48,574	2,248
Merger ratio	1	0.0462799

Source: DART, Mirae Asset Daewoo Research

Table 4. Expected changes in shareholders before and after merger

(no. of shares)

Shareholder	Pre-merger				Post-merger		
	Lotte Data Communication (merging)		HIT (merged)		Lotte Data Communication		Notes
	# of shares	Stake %	# of shares	Stake %	# of shares	%	
Lotte Corp.	10,000,000	70.0	0	0.0	10,000,000	65.0	Largest shareholder for the new entity
Lotte Data Communication	0	0.0	35,530,163	59.7	0	0.0	New shares will not be allotted to HIT shares held by Lotte Data Communication and HIT's treasury shares
HIT	0	0.0	15,385	0.0	0	0.0	
No. of shares issued	14,286,000	100.0	59,537,195	100.0	15,396,331	100.0	The number of issued shares will increase 7.8%

Source: DART, Mirae Asset Daewoo Research

Table 5. Expected effects of Lotte Data Communication-HIT merger

	Notes
Stronger synergies between businesses	- SOC: Application of HIT's railway signal system technologies to Lotte Data Communication's hi-pass and C-ITS projects - Finance: Synergies between Lotte Data Communication's credit card and capital solution businesses and HIT's banking and brokerage solution businesses - IDC center: Integrated operation of three data centers of Lotte Data Communication (in Seoul and Daejeon) and HIT (in Yongin).
Overseas expansion	- Utilization of Lotte Data Communication's three (Vietnam, Indonesia, and China) overseas subsidiaries' retail solution, overseas shopping mall and IBS business experiences and HIT's Vietnamese subsidiary and solution technologies in finance, brokerage, and medicine
Workforce integration (IT)	- Integration of IT personnel pools and R&D capabilities; strengthening of expertise via internalization of key businesses
Workforce integration (sales)	- Improvement in business opportunities by combining two companies' track records
Workforce integration (purchase)	- Bargaining power enhancement
Organization and workforce restructuring	- Improvement in workforce management via personnel relocations

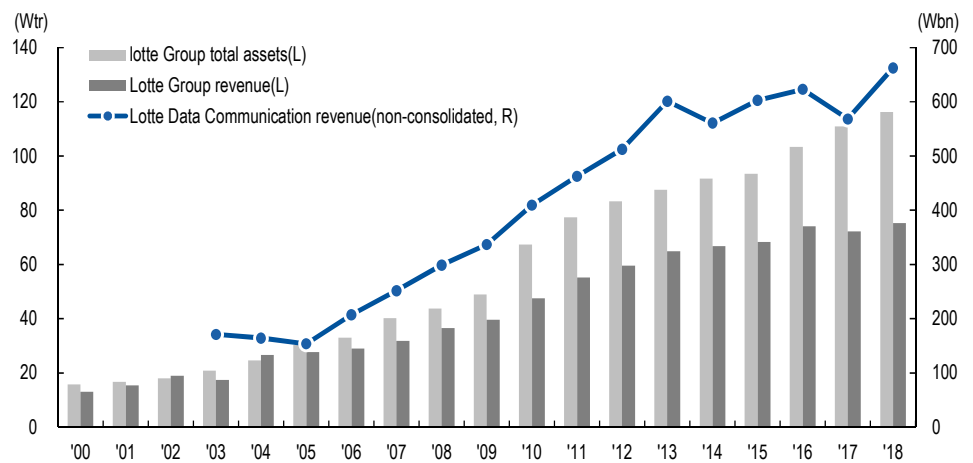
Source: Company data, Mirae Asset Daewoo Research

Table 6. Lotte Group's five-year investment plan (2019-23)

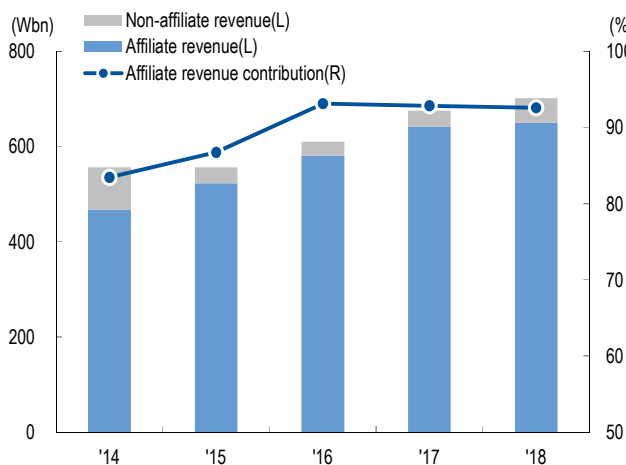
(Wbn)

	Details	Proportion	Value
Retail	<ul style="list-style-type: none"> Online business expansion - Digital transformation (AI, Big Data, etc.) Development of an integrated online shopping mall 	25%	12.5
F&B	<ul style="list-style-type: none"> New product development (AI utilization to increase) Expansion of production facilities 	10%	5.0
Chemicals/ construction	<ul style="list-style-type: none"> Capacity expansion at home and abroad Strengthening of cost competitiveness via feedstock diversification Expansion of value-added products 	40%	20.0
Tourism/services	Steady domestic and overseas expansion	25%	12.5
Total		100%	50.0

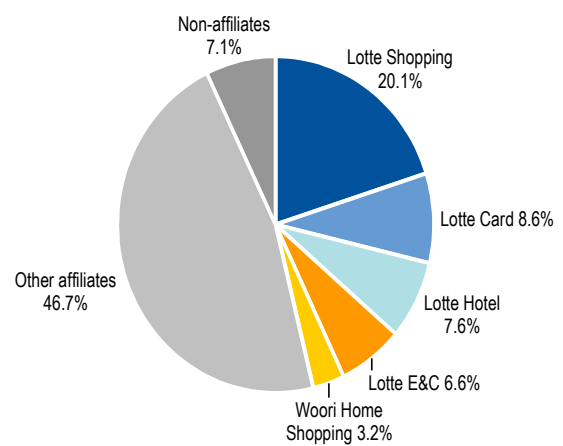
Source: Lotte Group, Mirae Asset Daewoo Research

Figure 1. Lotte Group's assets and revenue; Lotte Data Communication's revenue

Source: DART, Mirae Asset Daewoo Research

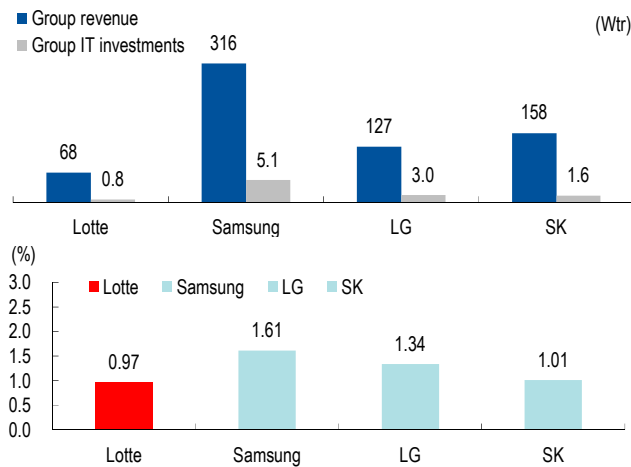
Figure 2. Affiliate revenue and contribution

Source: Company data, Mirae Asset Daewoo Research

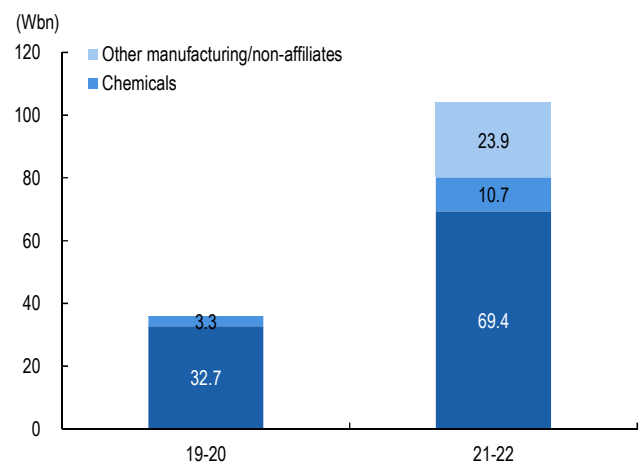
Figure 3. Revenue breakdown by customer

Note: Based on 2017 data

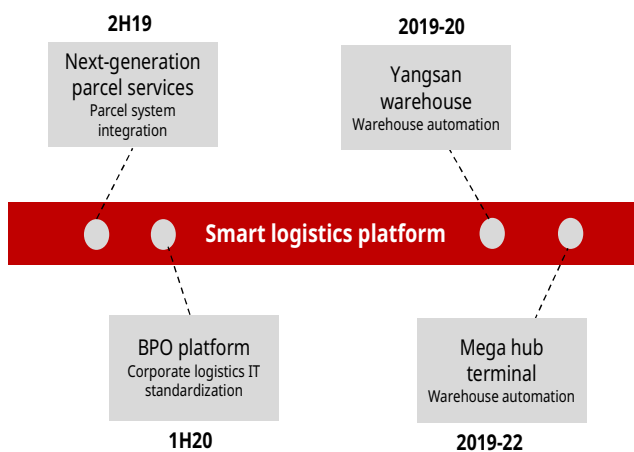
Source: DART, Mirae Asset Daewoo Research

Figure 4. IT investments-to-revenue ratio by major business group

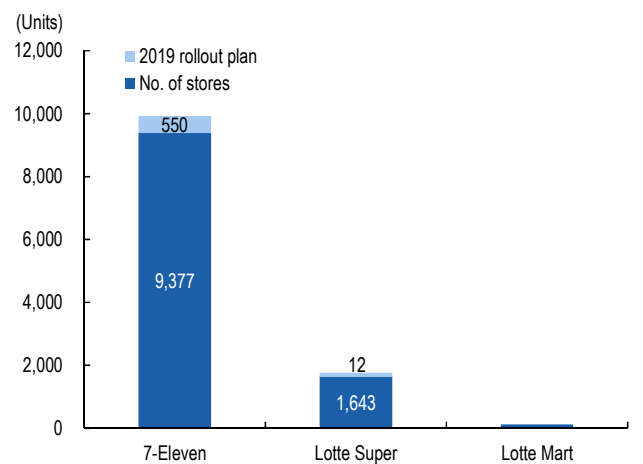
Source: Company data, Mirae Asset Daewoo Research

Figure 5. Lotte Data Communication's smart factory business plan

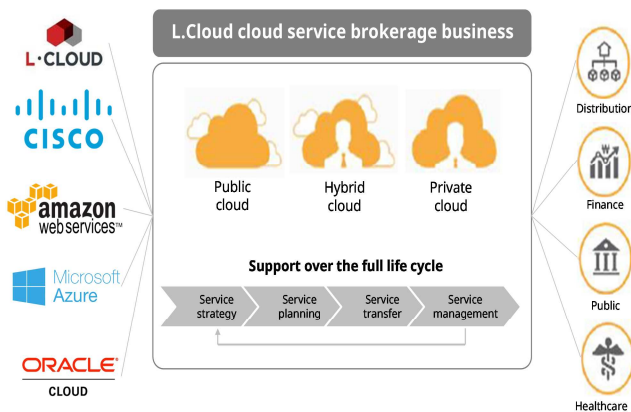
Source: Company data, Mirae Asset Daewoo Research

Figure 6. Lotte Group's smart logistics project

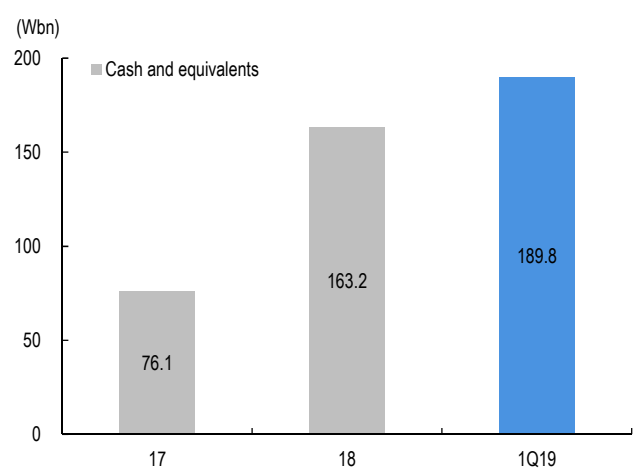
Source: Company data, Mirae Asset Daewoo Research

Figure 7. Lotte Group's retail store count

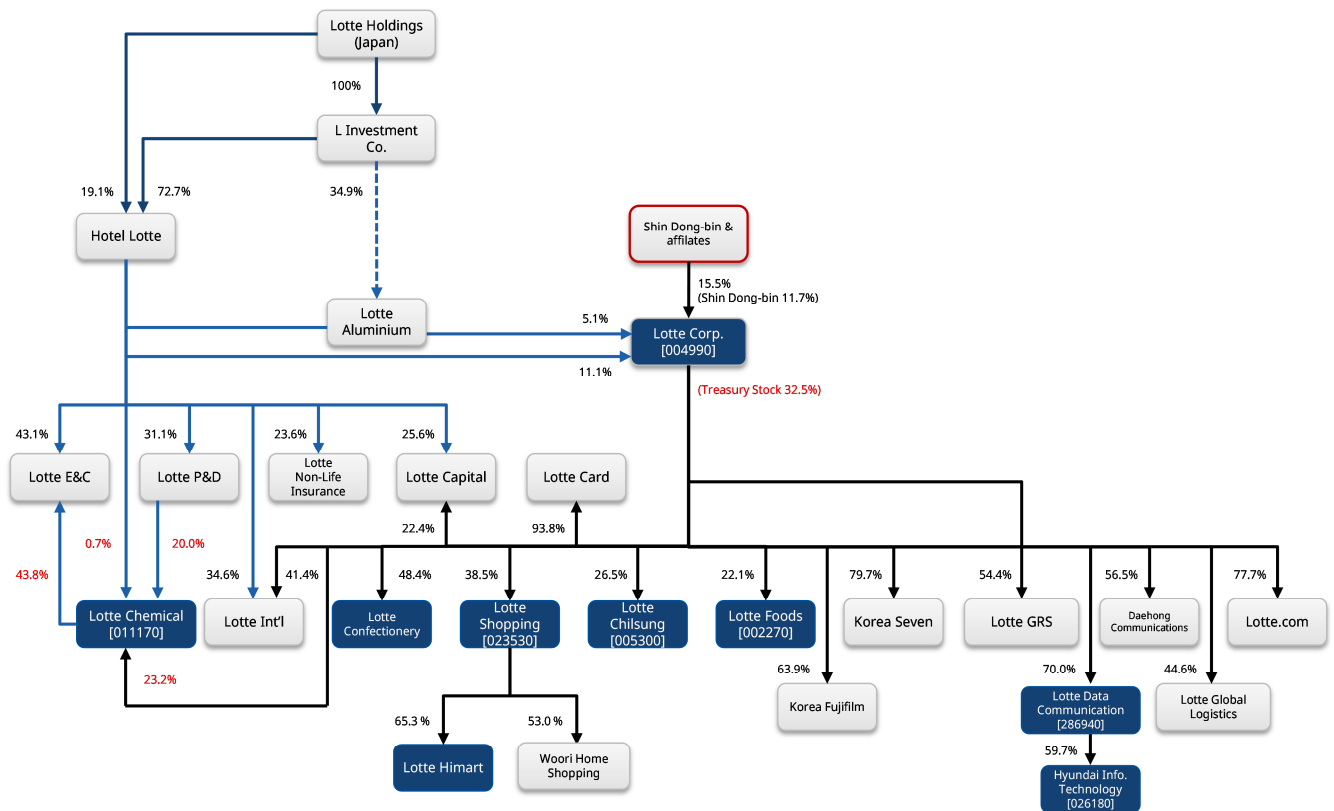
Source: Company data, Mirae Asset Daewoo Research

Figure 8. Lotte Data Communication's cloud service brokerage business

Source: Company data, Mirae Asset Daewoo Research

Figure 9. Cash and equivalents

Source: Company data, Mirae Asset Daewoo Research

Figure 10. Lotte Group's ownership structure (simplified)

Source: DART, Mirae Asset Daewoo Research

Lotte Data Communication (286940 KS/Buy/TP: W63,000)

Comprehensive Income Statement (Summarized)

(Wbn)	12/17	12/18	12/19F	12/20F
Revenue	149	812	910	1,016
Cost of Sales	137	741	827	920
Gross Profit	12	71	83	96
SG&A Expenses	6	32	38	42
Operating Profit (Adj)	5	39	45	54
Operating Profit	5	39	45	54
Non-Operating Profit	-2	-4	1	1
Net Financial Income	0	-1	0	0
Net Gain from Inv in Associates	0	0	0	0
Pretax Profit	3	35	46	55
Income Tax	0	11	14	16
Profit from Continuing Operations	2	23	31	39
Profit from Discontinued Operations	0	0	0	0
Net Profit	2	23	31	39
Controlling Interests	2	26	35	39
Non-Controlling Interests	1	-3	-3	0
Total Comprehensive Profit	3	23	31	39
Controlling Interests	3	26	40	50
Non-Controlling Interests	0	-3	-9	-11
EBITDA	10	71	75	77
FCF (Free Cash Flow)	-16	79	77	79
EBITDA Margin (%)	6.7	8.7	8.2	7.6
Operating Profit Margin (%)	3.4	4.8	4.9	5.3
Net Profit Margin (%)	1.3	3.2	3.8	3.8

Statement of Financial Condition (Summarized)

(Wbn)	12/17	12/18	12/19F	12/20F
Current Assets	280	404	505	607
Cash and Cash Equivalents	76	163	222	281
AR & Other Receivables	131	132	155	178
Inventories	17	12	14	17
Other Current Assets	56	97	114	131
Non-Current Assets	303	299	270	247
Investments in Associates	0	0	0	0
Property, Plant and Equipment	210	217	194	175
Intangible Assets	32	27	21	17
Total Assets	583	704	775	854
Current Liabilities	327	311	355	399
AP & Other Payables	162	193	227	261
Short-Term Financial Liabilities	123	61	61	61
Other Current Liabilities	42	57	67	77
Non-Current Liabilities	38	27	31	36
Long-Term Financial Liabilities	3	1	1	1
Other Non-Current Liabilities	35	26	30	35
Total Liabilities	365	337	386	435
Controlling Interests	197	348	376	405
Capital Stock	50	71	71	71
Capital Surplus	143	248	248	248
Retained Earnings	3	29	55	84
Non-Controlling Interests	21	18	14	14
Stockholders' Equity	218	366	390	419

Cash Flows (Summarized)

(Wbn)	12/17	12/18	12/19F	12/20F
Cash Flows from Op Activities	-10	107	77	79
Net Profit	2	23	31	39
Non-Cash Income and Expense	10	64	44	40
Depreciation	4	26	24	19
Amortization	1	6	6	5
Others	5	32	14	16
Chg in Working Capital	-22	25	16	16
Chg in AR & Other Receivables	-23	-2	-23	-23
Chg in Inventories	4	4	-2	-2
Chg in AP & Other Payables	-5	31	18	18
Income Tax Paid	0	-5	-14	-16
Cash Flows from Inv Activities	1	-77	-7	-7
Chg in PP&E	-6	-28	0	0
Chg in Intangible Assets	-3	-4	0	0
Chg in Financial Assets	-18	-40	-10	-10
Others	28	-5	3	3
Cash Flows from Fin Activities	-6	57	-12	-12
Chg in Financial Liabilities	126	-64	0	0
Chg in Equity	193	126	0	0
Dividends Paid	0	0	-9	-9
Others	-325	-5	-3	-3
Increase (Decrease) in Cash	-15	87	58	59
Beginning Balance	91	76	163	222
Ending Balance	76	163	222	281

Source: Company data, Mirae Asset Daewoo Research estimates

Forecasts/Valuations (Summarized)

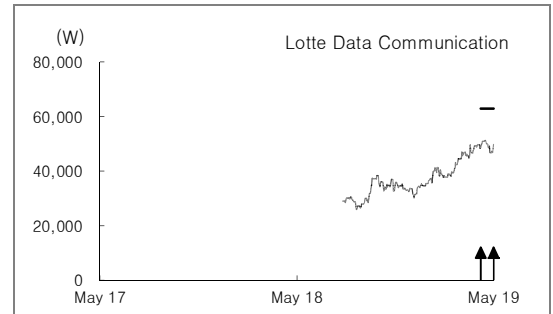
	12/17	12/18	12/19F	12/20F
P/E (x)	-	16.1	20.4	18.4
P/CF (x)	-	4.8	9.4	9.0
P/B (x)	-	1.4	1.9	1.8
EV/EBITDA (x)	-	5.1	6.7	5.6
EPS (W)	1,139	2,205	2,439	2,702
CFPS (W)	7,380	7,353	5,287	5,516
BPS (W)	19,679	24,419	26,271	28,323
DPS (W)	0	650	650	650
Payout ratio (%)	0.0	39.7	29.5	23.9
Dividend Yield (%)	-	1.8	1.3	1.3
Revenue Growth (%)	-	445.0	12.1	11.6
EBITDA Growth (%)	-	610.0	5.6	2.7
Operating Profit Growth (%)	-	680.0	15.4	20.0
EPS Growth (%)	-	93.6	10.6	10.8
Accounts Receivable Turnover (x)	1.1	6.3	6.5	6.2
Inventory Turnover (x)	8.9	56.0	67.8	65.1
Accounts Payable Turnover (x)	1.5	7.6	7.4	7.1
ROA (%)	0.4	3.6	4.3	4.8
ROE (%)	1.0	9.6	9.6	9.9
ROIC (%)	1.9	12.5	19.9	31.7
Liability to Equity Ratio (%)	167.8	92.1	99.0	103.8
Current Ratio (%)	85.5	130.1	142.4	152.0
Net Debt to Equity Ratio (%)	18.5	-42.9	-57.8	-70.2
Interest Coverage Ratio (x)	27.4	12.1	14.5	17.2

APPENDIX 1

Important Disclosures & Disclaimers

2-Year Rating and Target Price History

Company (Code)	Date	Rating	Target Price
Lotte Data Communication(286940)	04/09/2019	Buy	63,000



Stock Ratings

Buy	: Relative performance of 20% or greater
Trading Buy	: Relative performance of 10% or greater, but with volatility
Hold	: Relative performance of -10% and 10%
Sell	: Relative performance of -10%

Industry Ratings

Overweight	: Fundamentals are favorable or improving
Neutral	: Fundamentals are steady without any material changes
Underweight	: Fundamentals are unfavorable or worsening

Ratings and Target Price History (Share price (—), Target price (—), Not covered (≡), Buy (▲), Trading Buy (■), Hold (●), Sell (◆))

* Our investment rating is a guide to the relative return of the stock versus the market over the next 12 months.

* Although it is not part of the official ratings at Mirae Asset Daewoo Co., Ltd., we may call a trading opportunity in case there is a technical or short-term material development.

* The target price was determined by the research analyst through valuation methods discussed in this report, in part based on the analyst's estimate of future earnings.

* The achievement of the target price may be impeded by risks related to the subject securities and companies, as well as general market and economic conditions.

Equity Ratings Distribution & Investment Banking Services

	Buy	Trading Buy	Hold	Sell
Equity Ratings Distribution	83.52%	8.24%	8.24%	0.00%
Investment Banking Services	82.61%	4.35%	13.04%	0.00%

* Based on recommendations in the last 12-months (as of March 31, 2019)

Disclosures

We managed the IPO of Lotte Data Communication within the past one year.

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Mirae Asset Daewoo International Network

Mirae Asset Daewoo Co., Ltd. (Seoul)

Global Equity Sales Team
Mirae Asset Center 1 Building
26 Eulji-ro 5-gil, Jung-gu, Seoul 04539
Korea

Tel: 82-2-3774-2124

Mirae Asset Securities (USA) Inc.

810 Seventh Avenue, 37th Floor
New York, NY 10019
USA

Tel: 1-212-407-1000

PT. Mirae Asset Sekuritas Indonesia

Equity Tower Building Lt. 50
Sudirman Central Business District
Jl. Jend. Sudirman, Kav. 52-53 Jakarta Selatan
12190
Indonesia
Tel: 62-21-515-3281

Mirae Asset Securities Mongolia UTsK LLC

#406, Blue Sky Tower, Peace Avenue 17
1 Khoroo, Sukhbaatar District
Ulaanbaatar 14240
Mongolia

Tel: 976-7011-0806

Shanghai Representative Office

38T31, 38F, Shanghai World Financial Center
100 Century Avenue, Pudong New Area Shanghai
200120
China

Tel: 86-21-5013-6392

Mirae Asset Securities (HK) Ltd.

Suites 1109-1114, 11th Floor
Two International Finance Centre
8 Finance Street, Central
Hong Kong
China
Tel: 852-2845-6332

Mirae Asset Wealth Management (USA) Inc.

555 S. Flower Street, Suite 4410,
Los Angeles, California 90071
USA

Tel: 1-213-262-3807

Mirae Asset Securities (Singapore) Pte. Ltd.

6 Battery Road, #11-01
Singapore 049909
Republic of Singapore

Tel: 65-6671-9845

Mirae Asset Investment Advisory (Beijing) Co., Ltd

2401B, 24th Floor, East Tower, Twin Towers
B12 Jianguomenwai Avenue, Chaoyang District
Beijing 100022
China

Tel: 86-10-6567-9699

Ho Chi Minh Representative Office

7F, Saigon Royal Building
91 Pasteur St.
District 1, Ben Nghe Ward, Ho Chi Minh City
Vietnam

Tel: 84-8-3910-7715

Mirae Asset Securities (UK) Ltd.

41st Floor, Tower 42
25 Old Broad Street,
London EC2N 1HQ
United Kingdom

Tel: 44-20-7982-8000

Mirae Asset Wealth Management (Brazil) CCTVM

Rua Funchal, 418, 18th Floor, E-Tower Building Vila
Olimpia
Sao Paulo - SP
04551-060
Brasil
Tel: 55-11-2789-2100

Mirae Asset Securities (Vietnam) LLC

7F, Saigon Royal Building
91 Pasteur St.
District 1, Ben Nghe Ward, Ho Chi Minh City
Vietnam

Tel: 84-8-3911-0633 (ext.110)

Beijing Representative Office

2401A, 24th Floor, East Tower, Twin Towers
B12 Jianguomenwai Avenue, Chaoyang District
Beijing 100022
China

Tel: 86-10-6567-9699 (ext. 3300)