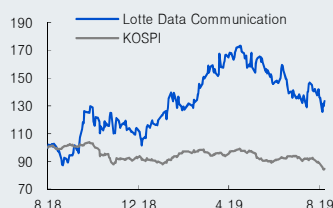


(Maintain)	Buy
Target Price (12M, W)	63,000
Share Price (08/08/19, W)	39,500
Expected Return	59%

OP (19F, Wbn)	49
Consensus OP (19F, Wbn)	46
EPS Growth (19F, %)	81.1
Market EPS Growth (19F, %)	-26.0
P/E (19F, x)	9.9
Market P/E (19F, x)	11.7
KOSPI	1,920.61

Market Cap (Wbn)	608
Shares Outstanding (mn)	15
Free Float (%)	30.5
Foreign Ownership (%)	1.2
Beta (12M)	0.18
52-Week Low	25,850
52-Week High	51,300

(%)	1M	6M	12M
Absolute	-0.3	1.8	30.4
Relative	7.2	15.4	56.2



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Lotte Data Communication

(286940 KS)

Earnings surprise; Watch for merger synergy in 2H19

2Q19 review: Earnings surprise, with consolidated OP of W13.7bn (+50.6% YoY)

For 2Q19, Lotte Data Communication announced consolidated revenue of W216.2bn (+8.1% YoY), operating profit of W13.7bn (+50.6% YoY), and net profit attributable to controlling interests of W31.1bn (+371.0% YoY). Operating profit handily beat our estimate (W11.1bn) and the market consensus (W9.8bn).

We believe the biggest highlight of the results is the rapid improvement in OP margin (6.3%; vs. 4.5% in 2Q18 and 3.0% in 1Q19), which we attribute to price increases (+3.4% YoY) in system management and the growing revenue mix of internally developed solutions in high-margin areas such as cloud and AI. We expect the system management unit to continue to drive margin improvement in 2H19.

Hyundai Information Technology (HIT), which was merged into Lotte Data Communication on July 1st, turned to an operating profit despite increased data center depreciation expenses (W5bn) in 2Q19. The Yongin data center began to normalize from end-March, with utilization reaching 95% in 2Q19 (contract basis), having a positive effect on operating profit. Meanwhile, net profit attributable to controlling interests sharply increased, reflecting a loss carryforward (approximately W15bn) related to the HIT merger.

Likely to exceed full-year earnings guidance; Merger synergy to materialize in 2H19

For the full year, we expect Lotte Data Communication to post revenue of W901.8bn (+11.1% YoY), operating profit of W49.1bn (+26.0% YoY), and net profit attributable to controlling interests of W59.2bn (+125.0% YoY), exceeding the company's guidance (revenue growth of more than 10% and OP margin of more than 4.8%). We expect quarterly operating profit to continue to improve YoY to W10.8bn (+46.7% YoY) in 3Q19 and W19bn (+15.8% YoY) in 4Q19.

We believe the merger with HIT has made Lotte Data Communication well-positioned to win data center and SOC projects (railway, airports and ports, etc.) in Korea and abroad. We expect cost savings from the merger to enable efficient resource allocation and enhance cost competitiveness, which will start being reflected in earnings from 2H19. Meanwhile, we expect Lotte Data Communication to pursue the acquisition of a fintech company in Vietnam using its cash holdings (W230bn).

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. Excluding a one-off factor on the non-operating side in 2Q19, the stock is currently trading at a 2019F P/E of 14x, a discount to peers such as Samsung SDS (018260 KS/Buy/TP: W290,000/CP: W199,000; 22x) and Hyundai Autoever (307950 KS/CP: W53,900; 19x). Valuation looks compelling on an absolute and relative basis.

Lotte Group is pursuing a digital transformation toward smart factories, smart logistics, and smart retail, with plans to invest W50tr in its domestic and overseas businesses over the next five years. 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.

FY (Dec.)	12/16	12/17	12/18	12/19F	12/20F	12/21F
Revenue (Wbn)	0	149	812	902	1,011	1,148
OP (Wbn)	0	5	39	49	57	68
OP Margin (%)	-	3.4	4.8	5.4	5.6	5.9
NP (Wbn)	0	2	26	59	46	55
EPS (W)	0	1,139	2,205	3,991	3,010	3,552
ROE (%)	0.0	1.0	9.6	15.8	11.1	11.9
P/E (x)	-	-	16.1	9.9	13.1	11.1
P/B (x)	-	-	1.4	1.5	1.4	1.3
Dividend Yield (%)	-	-	1.8	1.6	1.6	1.6

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. 2Q19 review

(Wbn, %)

	2Q18	1Q19	2Q19P		Growth	
			Preliminary	Consensus	QoQ	YoY
Revenue	200.0	186.5	216.2	217.8	16.0	8.1
OP	9.1	5.6	13.7	9.8	142.3	50.6
NP (controlling)	6.6	4.9	31.1	8.1	535.7	371.6
OP margin (%)	4.5	3.0	6.3	4.5	3.3	1.8
Net margin (%)	3.30	2.6	14.4	3.7	11.8	11.1

Source: Company data, FnGuide, Mirae Asset Daewoo Research

Table 1. Quarterly and annual earnings breakdown

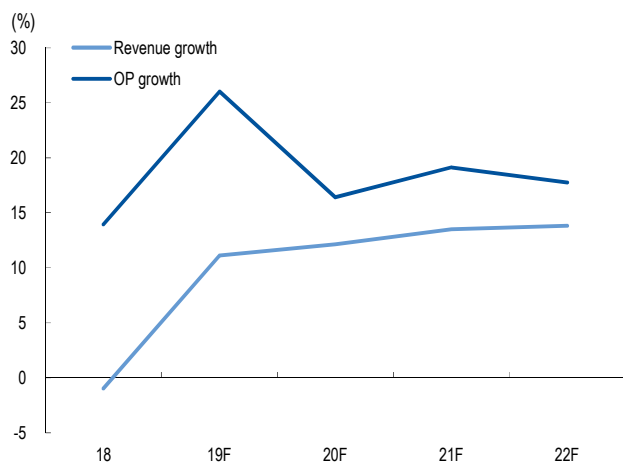
(Wbn, %)

	1Q18	2Q18	3Q18	4Q18	1Q19	2Q19P	3Q19F	4Q19F	2015	2016	2017	2018	2019F	2020F
Revenue	183.9	200.0	192.1	235.8	186.5	216.2	216.6	282.4	734.9	768.8	819.7	811.7	901.8	1,011.2
SM	41.1	42.8	45.2	48.8	46.1	48.1	51.1	59.9	127.0	138.1	151.1	177.9	205.2	224.0
SI	142.8	157.2	146.9	187.0	140.4	168.1	165.6	222.5	607.9	630.7	668.6	633.8	696.6	787.2
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	22.4%	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	77.6%	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	5.7	9.1	7.3	16.5	5.6	13.7	10.8	19.0	29.0	18.9	34.2	39.0	49.1	57.2
OP margin	3.1	4.5	3.8	7.0	3.0	6.3	5.0	6.7	3.9	2.5	4.2	4.8	5.4	5.7
SM	3.8	3.8	4.4	6.5	5.2	5.6	5.5	7.2	11.5	12.7	14.1	18.5	23.6	25.0
OP margin	9.2	8.9	9.7	13.3	11.3	11.7	10.8	12.0	9.1	9.2	9.4	10.4	11.5	11.2
SI	1.9	5.3	2.9	10.3	0.4	8.0	5.3	11.8	17.4	6.2	20.1	20.5	25.6	32.2
OP margin	1.4	3.4	2.0	5.5	0.3	4.8	3.2	5.3	2.9	1.0	3.0	3.2	3.7	4.1
Pretax profit	6.7	8.9	7.3	11.7	5.8	16.0	10.7	19.9	23.7	15.1	27.6	34.6	52.5	61.1
Net profit	4.5	6.3	4.4	8.2	3.3	31.1	8.1	15.1	16.9	11.9	20.6	23.4	57.6	46.3
Net profit (controlling)	5.4	6.6	4.7	9.6	4.9	31.1	8.1	15.1	16.9	11.9	20.8	26.3	59.2	46.3
YoY growth														
Revenue	-	-	-	-	1.4	8.1	12.8	19.8	2.4	4.6	6.6	-1.0	11.1	12.1
Security systems services	-	-	-	-	12.2	12.4	13.0	22.7	4.7	8.7	9.4	17.7	15.3	9.2
Building management	-	-	-	-	-1.7	6.9	12.7	19.0	1.9	3.8	6.0	-5.2	9.9	13.0
Call center & telemarketing	-	-	-	-	-1.7	50.6	46.7	15.8	2.1	-34.7	80.7	14.0	26.0	16.4
Operating profit	-	-	-	-	36.8	48.1	25.4	10.8	8.1	10.3	11.2	30.8	27.3	6.3
Security systems	-	-	-	-	-77.2	52.4	78.4	14.7	-1.5	-64.4	223.4	2.1	24.9	25.7
Building management	-	-	-	-	-13.3	79.7	47.0	70.4	1.0	-36.3	82.8	25.4	51.7	16.5
Call center & telemarketing	-	-	-	-	-26.0	396.4	85.3	83.5	1.0	-29.6	73.1	13.4	146.6	-19.6
Pretax profit	-	-	-	-	-9.4	371.6	73.8	56.6	1.0	-29.6	74.8	26.5	125.0	-21.7

Note: 2Q19 net profit reflects a loss carryforward (approximately W15bn) related to the HIT merger.

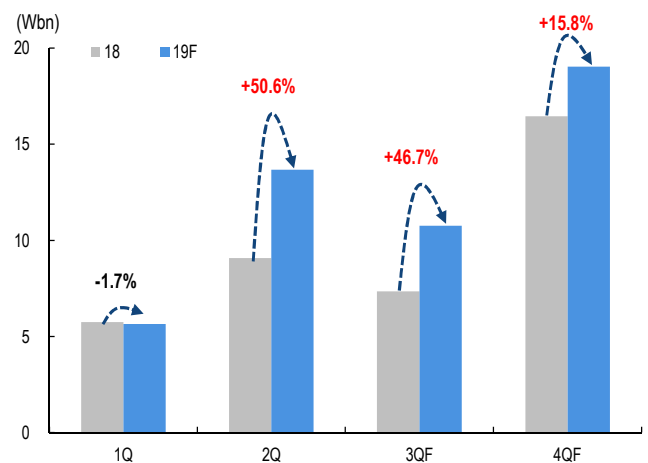
Source: Company data, Mirae Asset Daewoo Research

Figure 1. Operating profit growth outpaces revenue growth



Source: Company data, Mirae Asset Daewoo Research

Figure 2. Quarterly OP growth: 2018 vs. 2019



Source: Company data, Mirae Asset Daewoo Research

Table 3. Expected effects of Lotte Data Communication-HIT merger

	Notes
Stronger synergies between businesses	<ul style="list-style-type: none"> - 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 solutions businesses and HIT's banking and brokerage solution businesses - IDC: 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 solutions, overseas shopping mall, and IBS business experience as well as HIT's Vietnamese subsidiary and solutions technologies (finance, brokerage, healthcare)
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' strengths and experience
Workforce integration (purchasing)	- Bargaining power enhancement
Organization and workforce restructuring	- Improvement in workforce management via personnel relocation

Source: Company materials, Mirae Asset Daewoo Research

Table 2. Expected changes: Pre-merger vs. post-merger

Shareholder	Pre-merger				Post-merger		
	Lotte Data Communication (acquirer)		HIT (acquiree)		Lotte Data Communication		Notes
	No. of shares	Stake (%)	No. of shares	Stake (%)	No. of shares	%	
Lotte Corp.	10,000,000	70.0	0	0.0	10,000,000	65.0	Largest shareholder of post-merger entity
Employee shares	803,558	5.6	0	0	693,089	4.5	
Lotte Data Communication	0	0.0	35,530,163	59.7	0	0.0	New shares will not be allotted for HIT shares held by Lotte Data
HIT	0	0.0	15,385	0.0	0	0.0	
Treasury stock	0				266,964	1.7	Communication and HIT's treasury stock
No. of issued shares	14,286,000	100.0	59,537,195	100.0	15,396,331	100.0	No. of issued shares will increase by 7.8%

Source: DART, Mirae Asset Daewoo Research

Figure 3. Current integrated data center overview



Source: Company materials, Mirae Asset Daewoo Research

Figure 4. Construction of fourth data center (global cloud center) underway



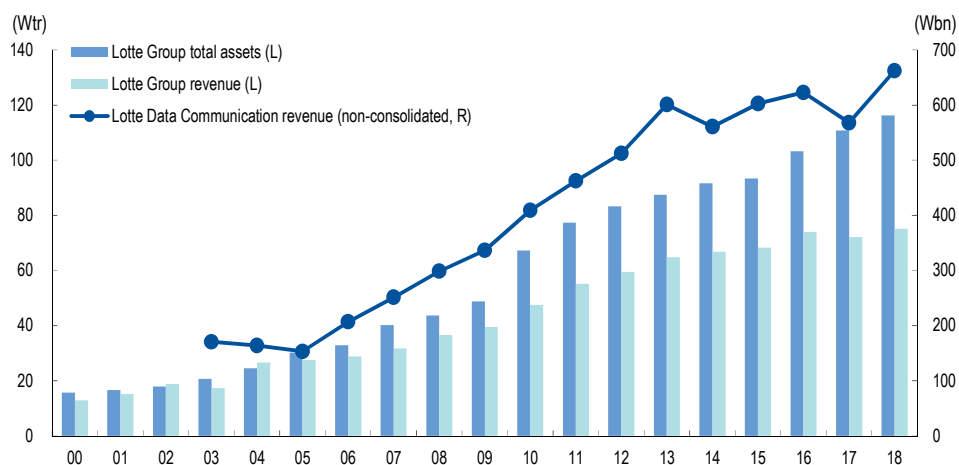
Source: Company materials, Mirae Asset Daewoo Research

Table 5. Lotte Group's five-year investment plan (2019-23)

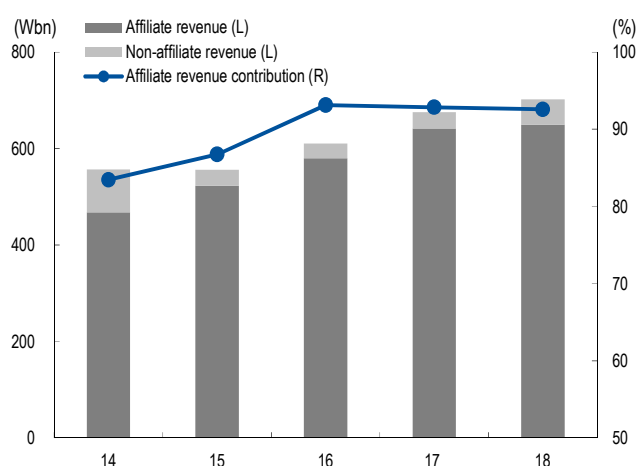
(Wbn)

	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 adoption 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

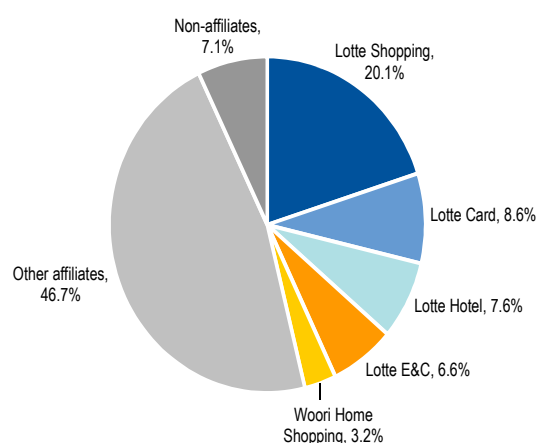
Source: Lotte Group, Mirae Asset Daewoo Research

Figure 5. Lotte Group's assets and revenue; Lotte Data Communication's revenue

Source: Company data, Mirae Asset Daewoo Research

Figure 6. Affiliate revenue and contribution

Source: Company data, Mirae Asset Daewoo Research

Figure 7. Revenue breakdown by customer

Source: Company data, Mirae Asset Daewoo Research

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

Comprehensive Income Statement (Summarized)

(Wbn)	12/18	12/19F	12/20F	12/21F
Revenue	812	902	1,011	1,148
Cost of Sales	741	816	913	1,033
Gross Profit	71	86	98	115
SG&A Expenses	32	37	41	46
Operating Profit (Adj)	39	49	57	68
Operating Profit	39	49	57	68
Non-Operating Profit	-4	3	4	4
Net Financial Income	-1	1	1	1
Net Gain from Inv in Associates	0	0	0	0
Pretax Profit	35	52	61	72
Income Tax	11	-5	15	17
Profit from Continuing Operations	23	58	46	55
Profit from Discontinued Operations	0	0	0	0
Net Profit	23	58	46	55
Controlling Interests	26	59	46	55
Non-Controlling Interests	-3	-2	0	0
Total Comprehensive Profit	23	58	46	55
Controlling Interests	26	81	64	76
Non-Controlling Interests	-3	-23	-18	-21
EBITDA	71	83	84	89
FCF (Free Cash Flow)	79	90	89	97
EBITDA Margin (%)	8.7	9.2	8.3	7.8
Operating Profit Margin (%)	4.8	5.4	5.6	5.9
Net Profit Margin (%)	3.2	6.5	4.5	4.8

Statement of Financial Condition (Summarized)

(Wbn)	12/18	12/19F	12/20F	12/21F
Current Assets	404	532	648	784
Cash and Cash Equivalents	163	237	306	380
AR & Other Receivables	132	158	184	217
Inventories	12	15	17	20
Other Current Assets	97	122	141	167
Non-Current Assets	299	280	253	233
Investments in Associates	0	0	0	0
Property, Plant and Equipment	217	202	180	163
Intangible Assets	27	21	17	13
Total Assets	704	812	902	1,017
Current Liabilities	311	363	411	475
AP & Other Payables	193	231	269	318
Short-Term Financial Liabilities	61	63	63	63
Other Current Liabilities	57	69	79	94
Non-Current Liabilities	27	34	39	45
Long-Term Financial Liabilities	1	3	3	3
Other Non-Current Liabilities	26	31	36	42
Total Liabilities	337	396	450	521
Controlling Interests	348	399	436	480
Capital Stock	71	71	71	71
Capital Surplus	248	248	248	248
Retained Earnings	29	80	116	161
Non-Controlling Interests	18	16	16	16
Stockholders' Equity	366	415	452	496

Cash Flows (Summarized)

(Wbn)	12/18	12/19F	12/20F	12/21F
Cash Flows from Op Activities	107	103	89	97
Net Profit	23	58	46	55
Non-Cash Income and Expense	64	32	40	37
Depreciation	26	27	22	17
Amortization	6	7	5	4
Others	32	-2	13	16
Chg in Working Capital	25	6	18	23
Chg in AR & Other Receivables	-2	-27	-25	-33
Chg in Inventories	4	-2	-2	-3
Chg in AP & Other Payables	31	1	20	26
Income Tax Paid	-5	7	-15	-17
Cash Flows from Inv Activities	-77	-27	-8	-11
Chg in PP&E	-28	-13	0	0
Chg in Intangible Assets	-4	-1	0	0
Chg in Financial Assets	-40	-11	-11	-15
Others	-5	-2	3	4
Cash Flows from Fin Activities	57	-3	-12	-12
Chg in Financial Liabilities	-64	4	0	0
Chg in Equity	126	0	0	0
Dividends Paid	0	0	-10	-10
Others	-5	-7	-2	-2
Increase (Decrease) in Cash	87	74	70	74
Beginning Balance	76	163	237	306
Ending Balance	163	237	306	380

Source: Company data, Mirae Asset Daewoo Research estimates

Forecasts/Valuations (Summarized)

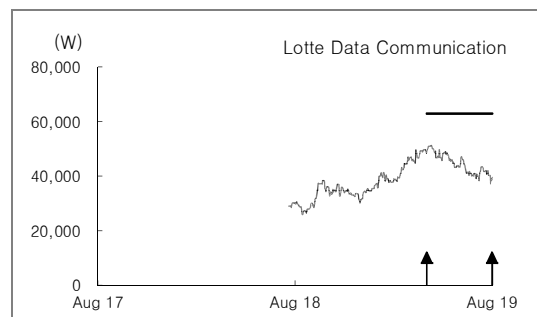
	12/18	12/19F	12/20F	12/21F
P/E (x)	16.1	9.9	13.1	11.1
P/CF (x)	4.8	6.5	7.0	6.6
P/B (x)	1.4	1.5	1.4	1.3
EV/EBITDA (x)	5.1	4.6	3.6	2.4
EPS (W)	2,205	3,991	3,010	3,552
CFPS (W)	7,353	6,044	5,625	5,968
BPS (W)	24,419	25,926	28,287	31,189
DPS (W)	650	650	650	650
Payout ratio (%)	39.7	17.4	21.6	18.3
Dividend Yield (%)	1.8	1.6	1.6	1.6
Revenue Growth (%)	445.0	11.1	12.1	13.6
EBITDA Growth (%)	610.0	16.9	1.2	6.0
Operating Profit Growth (%)	680.0	25.6	16.3	19.3
EPS Growth (%)	93.6	81.0	-24.6	18.0
Accounts Receivable Turnover (x)	6.3	6.4	6.1	5.9
Inventory Turnover (x)	56.0	66.5	63.3	61.2
Accounts Payable Turnover (x)	7.6	7.2	6.9	6.6
ROA (%)	3.6	7.6	5.4	5.7
ROE (%)	9.6	15.8	11.1	11.9
ROIC (%)	12.5	34.7	34.2	57.9
Liability to Equity Ratio (%)	92.1	95.4	99.7	104.9
Current Ratio (%)	130.1	146.6	157.6	165.0
Net Debt to Equity Ratio (%)	-42.9	-58.6	-71.7	-83.1
Interest Coverage Ratio (x)	12.1	22.8	26.5	31.6

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	83.14%	8.72%	8.14%	0.00%
Investment Banking Services	77.78%	11.11%	11.11%	0.00%

* Based on recommendations in the last 12-months (as of June 30, 2019)

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