

Overweight (Maintain)

Industry Report
September 23, 2019

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[Conglomerates/Software]

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Conglomerates

Lotte Group: The transformation begins

Stake sales will allow Lotte Corp. to meet holding company requirements and clear uncertainties

Lotte Corp. (initiate coverage; 004990 KS/Buy/TP: W52,000/CP: W37,800) is currently in the process of selling its stakes in financial affiliates, including Lotte Card and Lotte Capital, to comply with fair trade laws, which prohibit general holding companies from owning shares in financial companies. The company is required to complete the stake disposals by October 11th. On September 17th, media reports indicated that the Financial Services Commission (FSC) is set to approve the MBK Partners/Woori Bank consortium as Lotte Card's majority shareholder on October 2nd. In addition, there are reports that Lotte Corp. plans to sell its 25.6% stake in Lotte Capital to Japan-based Lotte Holdings. If the stake sales are completed within the deadline, we believe this would be positive for Lotte Corp., as it would allow the company to meet its holding company requirements and clear uncertainties.

Major group issues: Massive digital transformation-focused investments and asset securitization create positive investment cycle

(1) Five-year, W50tr investment plan

By business segment, retail will account for 25% of the planned investment, food 10%, chemicals/construction 40%, and tourism/services 25%.

Lotte Group plans to make massive investments through 2023, in a bid to enhance the competitiveness of its businesses and identify future growth engines. In particular, the retail business, led by Lotte Shopping (023530 KS/Trading Buy/TP: W162,000/CP: W135,000), aims to increase its online revenue from W7tr in 2018 to W20tr in 2022 by investing heavily in online operations (e.g., integrating its online malls and establishing distribution systems).

(2) Group digital transformation

Lotte Corp. has launched a digital transformation strategy that focuses on realizing smart factory, smart logistics, smart retail, and smart services across the group. By building what it calls the "One Lotte Smart Ecosystem," the group is looking to realize IT-based business innovation and strengthen competitiveness to ensure sustainable growth.

(3) Lotte REIT likely to go public in late October

Lotte Group plans to list Lotte REIT, which owns 10 Lotte Shopping stores, in late October. Lotte REIT is expected to offer a stable annual dividend yield of around 6% through master leases with Lotte Shopping.

Lotte REIT sets in motion investment idea: Lotte REIT → Lotte Shopping → Lotte Data Communication → Lotte Corp.

Lotte REIT (to be listed): Annual dividend yield of around 6% (company estimate)

Lotte Shopping: Likely to raise W1tr through asset securitization, which the company plans to use on new businesses, including online operations

Lotte Data Communication (286940 KS/Buy/TP: W63,000/CP: W41,500): IT investments and push for digital transformation by affiliates, such as Lotte Shopping, to create business opportunities

Lotte Corp.: A rise in the value of subsidiary stakes (40% in Lotte Shopping and 65% in Lotte Data Communication) could trigger a re-rating.

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Investment summary

Lotte REIT sets in motion investment idea

(1) Lotte REIT to go public in late October

Lotte Group plans to list Lotte REIT, which owns 10 Lotte Shopping stores, in late October. Lotte REIT plans to offer a stable annual dividend yield of around 6% (to be distributed twice a year for the periods ending in June and December) based on rental income (which will increase 1.5% annually) stemming from a master lease with Lotte Shopping.

Table 1. Lotte REIT's IPO outline

IPO details	Notes
No. of shares to be issued	85,984,442 common shares (institutional investors 65%, retail subscribers 35%)
Assumed price of new shares	W4,750-5,000
Total value of new shares	W408.4-429.9bn
Book building	9/23/2019-10/2/2019
Expected IPO date	Late October 2019
Largest shareholder on a post-IPO basis	Lotte Shopping (50% stake, 85,984,442 shares), lock-up period: One year from May 2019
Dividend payout	For periods ending in June and December

Source: DART, Mirae Asset Daewoo Research

Table 2. Lotte REIT: Target dividend yield

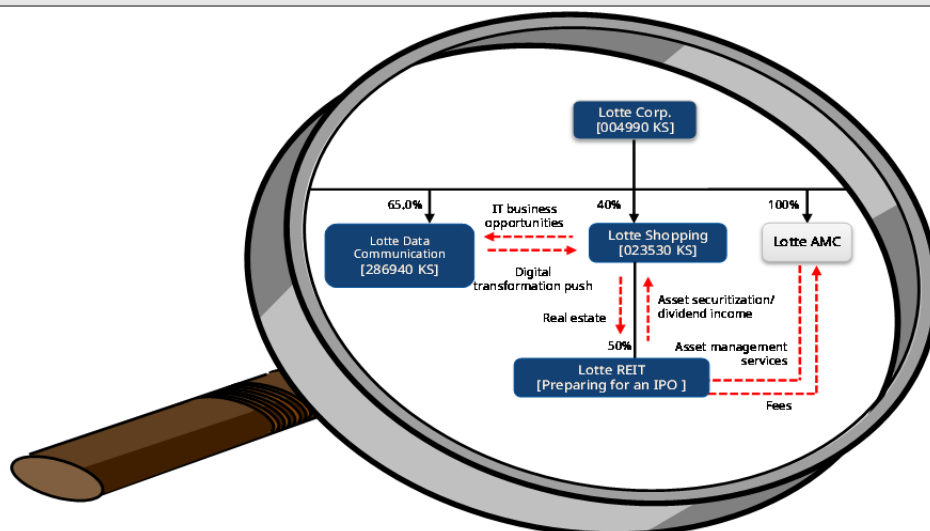
Based on W4,750		2019 final	2020 interim	2020 final	2021 interim	Based on W5,000		2019 final	2020 interim	2020 final	2021 interim
Expected target dividend yield	IPO investors	10.57%	6.62%	6.66%	6.75%	Expected target dividend yield	IPO investors	10.11%	6.35%	6.39%	6.48%
	Lotte Shopping	3.35%	6.29%	6.33%	6.41%		Lotte Shopping	3.37%	6.35%	6.39%	6.48%

Source: DART, Mirae Asset Daewoo Research

(2) Lotte REIT sets in motion investment idea: Lotte REIT → Lotte Shopping → Lotte Data Communication → Lotte Corp.

- ① Lotte REIT (to be listed): Annual dividend yield of around 6% (company estimate)
- ② Lotte Shopping: Likely to raise W1tr through asset securitization, which the company plans to use on new businesses, including online operations
- ③ Lotte Data Communication: IT investments and push for digital transformation by affiliates, such as Lotte Shopping, to create business opportunities
- ④ Lotte Corp.: Rise in value of subsidiary stakes (40% in Lotte Shopping and 65% in Lotte Data Communication) could trigger re-rating

Figure 1. Lotte Group investment idea: Lotte REIT IPO → Lotte Shopping → Lotte Data Communication → Lotte Corp.



Source: Mirae Asset Daewoo Research

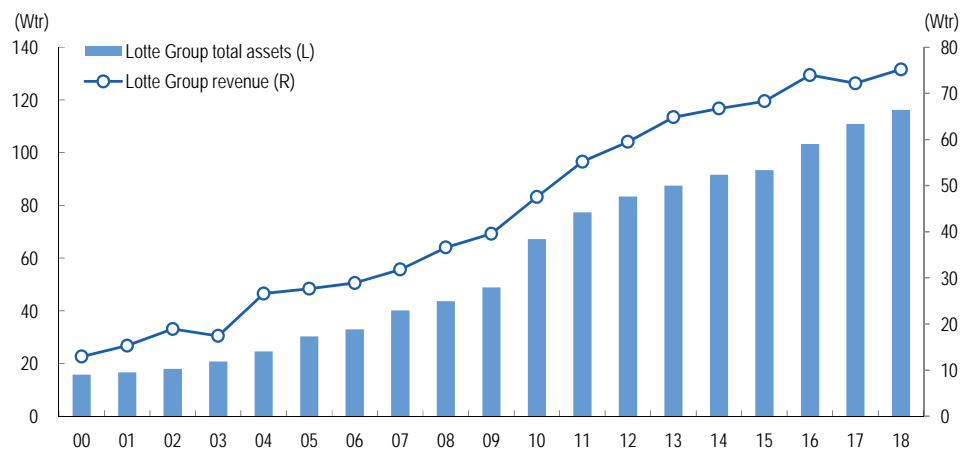
I. Current status

1. Group trends and business portfolio

1) Fifth-largest conglomerate group

Lotte Group is Korea's fifth-largest conglomerate group by assets (as of August 2019) and owns 96 domestic affiliates (11 listed and 85 unlisted). As of 2018, the group controlled total assets of W115tr (-0.8% YoY) and recorded total revenue of W73tr (-2.3% YoY). Total revenue slightly decreased from the 2017 peak, as revenues from core businesses contracted as a result of a number of domestic and overseas headwinds, including slowing growth, changes in consumer behavior, and the THAAD issue.

Figure 2. Lotte Group's assets and revenue



Source: FTC, Mirae Asset Daewoo Research

Table 3. Domestic conglomerate ranking

(No.)

Rank	Company	Head	No. of affiliates	Rank	Company	Head	No. of affiliates	Rank	Company	Head	No. of affiliates	Rank	Company	Head	No. of affiliates
1	Samsung	Lee Jae-yong	62	17	LS	Koo Ja-hong	52	33	HDC	Chung Mong-gyu	24	47	Nexon	Kim Jung-joo	21
2	Hyundai Motor	Chung Mong-koo	52	18	Daelim	Lee Joon-yong	27	34	KCC	Chung Mong-jin	15	48	Dongwon	Kim Jae-chul	23
3	SK	Chey Tae-won	113	19	Mirae Asset	Park Hyeon-joo	38	35	SM	Woo Oh-hyun	63	49	Halla	Chung Mong-won	15
4	LG	Koo Kwang-mo	73	21	Hyundai Department	Chung Ji-sun	28	37	Jungheung	Jung Chang-sun	40	50	AmorePacific	Suh Kyeong-bae	14
5	Lotte	Shin Dong-bin	96	22	Hyosung	Cho Seok-rae	57	38	Hankook Tire	Cho Yang-rae	23	51	Samchully	Lee Man-deuk	20
7	Hanwha	Kim Seung-youn	86	23	KIH	Kim Nam-goo	31	39	SeaAH	Lee Soon-hyung	25	53	Dongkuk	Jang Se-soo	12
8	GS	Huh Chang-soo	64	25	Young Poong	Chang Hyung-jin	24	40	Taekwang	Lee Ho-jin	23	54	Eugene	Yoo Kyung-sun	53
10	HHI	Chung Mong-joon	29	26	Harim	Kim Hong-kuk	53	41	E-Land	Park Sung-soo	31	55	Kumho Petrochemical	Park Chan-koo	11
11	Shinsegae	Lee Myung-hee	40	27	Kyobo	Shin Chang-jae	14	42	Celltrion	Seo Jung-jin	10	56	HiteJinro	Park Moon-deuk	17
13	Hanjin	Cho Won-tae	31	28	Kumho Asiana	Park Sam-koo	27	43	DB	Kim Jun-ki	20	57	Netmarble	Bang Jun-hyuk	23
14	CJ	Lee Jae-hyun	79	30	Kolon	Lee Woong-yeol	42	44	Hoban	Kim Sang-yeol	32	58	Aekyung	Jang Young-shin	39
15	Doosan	Park Jeong-won	23	31	OCI	Lee Woo-hyun	18	45	NAVER	Lee Hae-jin	38	59	Daou Kiwoom	Kim Ik-rae	57
16	Booyoung	Lee Joong-keun	24	32	Kakao	Kim Bum-soo	73	46	Taeyoung	Yoon Se-young	54				

Note: Based on total assets (as of August 1, 2019)

Source: FTC, Mirae Asset Daewoo Research

2) Business portfolio

Lotte Group's main business areas are F&B, retail, petrochemicals, tourism/services, and construction (E&C), which represented 9%, 29%, 24%, 9%, and 9% of revenue, respectively, in 2018. Because overall revenue growth is centered on F&B and retail, the group's earnings are directly impacted by changes in domestic demand. That said, the petrochemical business, which has seen its revenue and profit contributions increase since 2015 due to thriving market conditions, provides some buffer against earnings volatility within the group.

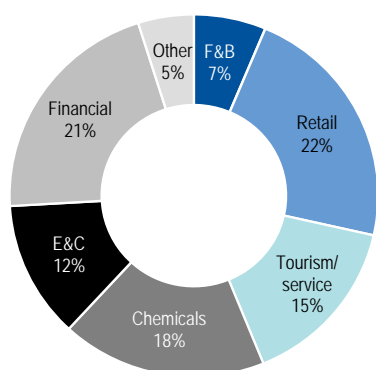
Meanwhile, Lotte Shopping and Lotte Chemical (011170 KS/Trading Buy/TP: W270,000/CP: W245,500), the two biggest contributors to revenue and profits, have seen margins modestly recover since 2018 and 2019, respectively, despite revenue remaining stagnant.

Table 4. Lotte Group's business portfolio

	No. of affiliates by sector
F&B	12 (e.g., Lotte Confectionery, Lotte Chilsung, Lotte Foods, Lotte GRS)
Retail	15 (e.g., Lotte Shopping, Lotte Himart, Korea Seven, Lotte Home Shopping)
Chemicals	9 (e.g., Lotte Chemical, Lotte Fine Chemical)
Tourism/services	6 (e.g., Hotel Lotte, Busan Hotel Lotte)
Construction (E&C)	11 (e.g., Lotte E&C, Lotte P&D, Lotte Asset Development)
Financial	15 (e.g., Lotte Card, Lotte Capital, Lotte Non-Life Insurance)

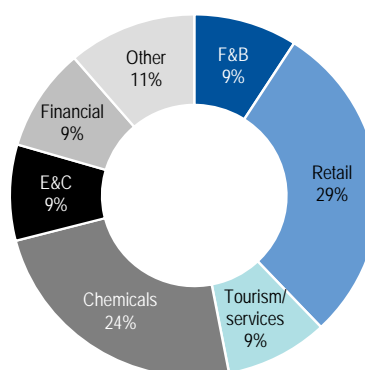
Source: Korea Ratings, Mirae Asset Daewoo Research

Figure 3. Lotte Group: Asset breakdown by business



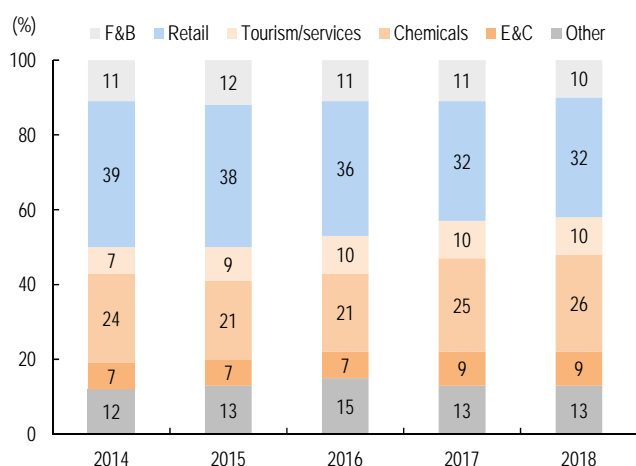
Note: Based on 2018 data
Source: Korea Ratings, Mirae Asset Daewoo Research

Figure 4. Lotte Group: Revenue breakdown by business



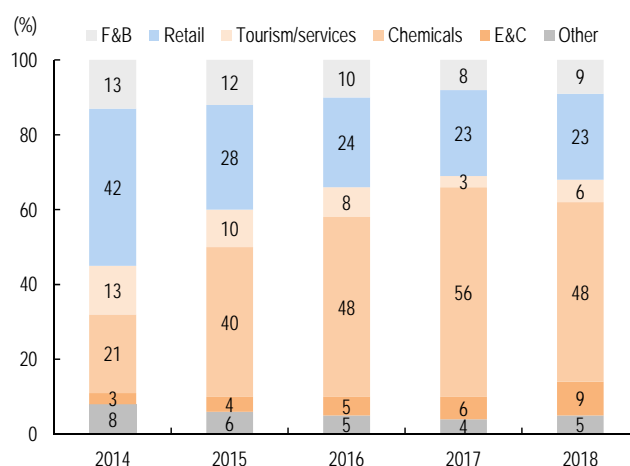
Note: Based on 2018 data
Source: Korea Ratings, Mirae Asset Daewoo Research

Figure 5. Lotte Group: Revenue breakdown by business

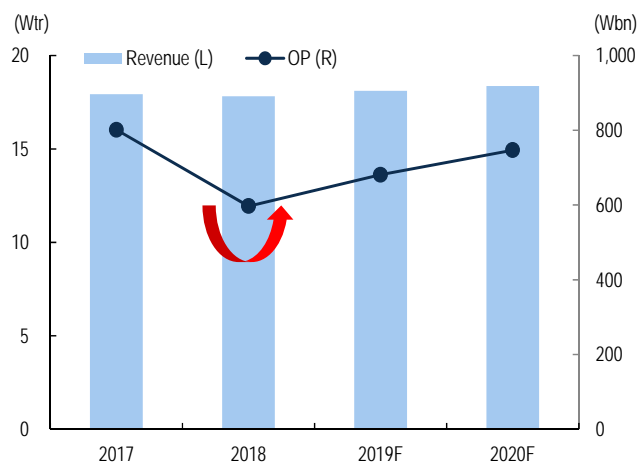


Note: Excluded the financial business
Source: Korea Ratings, Mirae Asset Daewoo Research

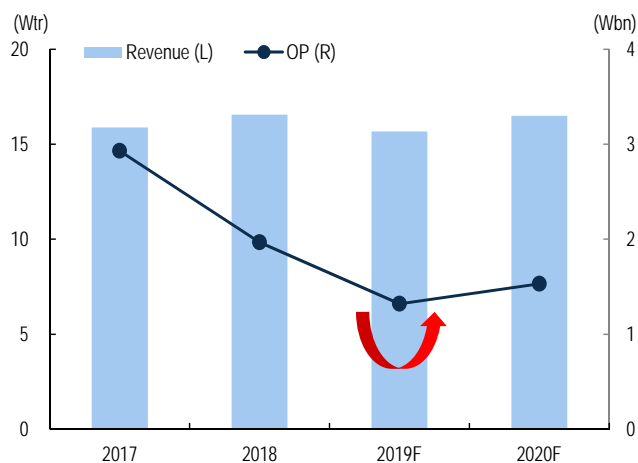
Figure 6. Lotte Group: EBITDA breakdown by business



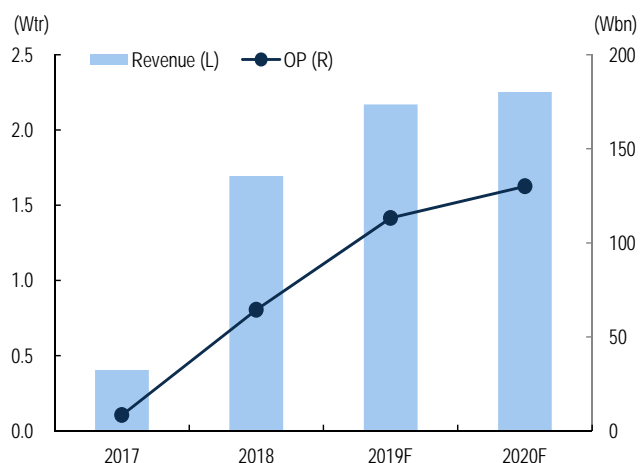
Note: Excluded the financial business
Source: Korea Ratings, Mirae Asset Daewoo Research

Figure 7. Lotte Shopping: Annual earnings

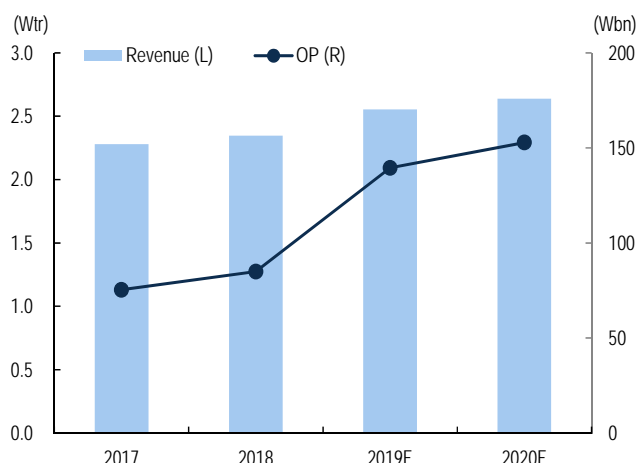
Source: FnGuide, Mirae Asset Daewoo Research

Figure 8. Lotte Chemical: Annual earnings

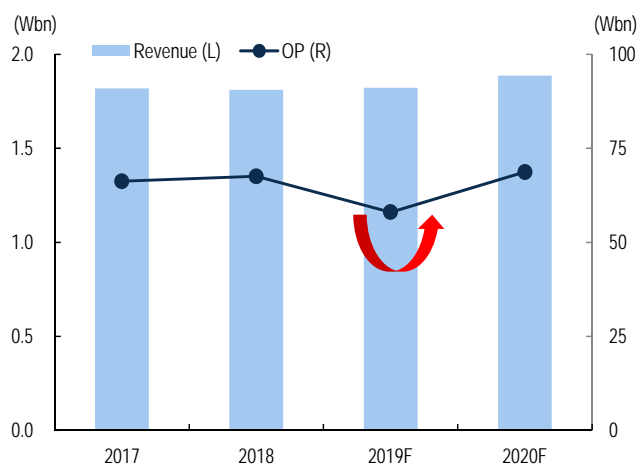
Source: FnGuide, Mirae Asset Daewoo Research

Figure 9. Lotte Confectionery: Annual earnings

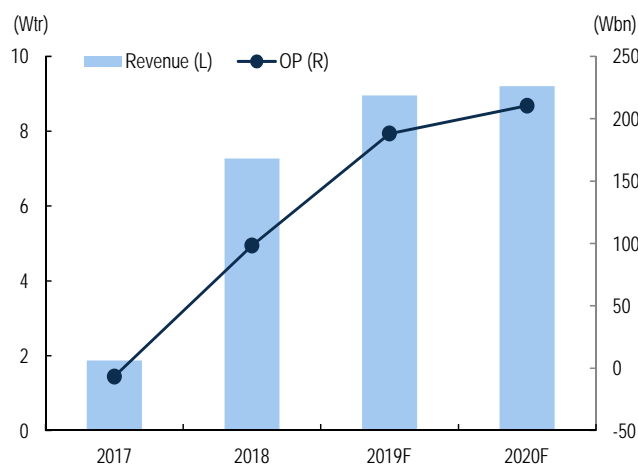
Source: FnGuide, Mirae Asset Daewoo Research

Figure 10. Lotte Chilsung: Annual earnings

Source: FnGuide, Mirae Asset Daewoo Research

Figure 11. Lotte Foods: Annual earnings

Source: FnGuide, Mirae Asset Daewoo Research

Figure 12. Lotte Corp.: Annual earnings

Source: FnGuide, Mirae Asset Daewoo Research

2. Ownership structure

1) Holding company conversion

In October 2017, Lotte Group established Lotte Corp. by merging the investment units spun off from Lotte Confectionery (280360 KS/CP: W149,500), Lotte Shopping, Lotte Chilsung (005300 KS/Buy/TP: W220,000/CP: W139,000), and Lotte Foods (002270 KS/Buy/TP: W790,000/CP: W447,500), in order to convert to a holding company structure. Since then, Lotte Corp. has taken steps to legally qualify as a holding company under the Monopoly Regulation and Fair Trade Act (MRFTA), while overhauling its ownership structure to strengthen its control over subsidiaries.

In April 2018, Lotte Corp. merged with Lotte IT Tech and the investment units spun off from Lotte GRS, Lotte International, Lotte Logistics, Korea Fujifilm, and Daehong Communications, fully unwinding the group's circular/cross-shareholdings and tightening its grip on non-retail/F&B businesses. In June 2018, Lotte Corp. exchanged shares with Lotte Confectionery and Lotte Chilsung through tender offers, increasing its equity stakes in the two companies and meeting the subsidiary ownership requirements under the MRFTA.

In October 2018, Lotte Corp. acquired a 23.2% stake in Lotte Chemical (7.97mn shares for W2.2tr) from Hotel Lotte and Lotte Property & Development, bringing the chemical business (which contributes a large portion of group profits) under the holding company structure. The move also expanded the company's business portfolio into construction by adding Lotte E&C, a subsidiary of Lotte Chemical, to the holding company structure.

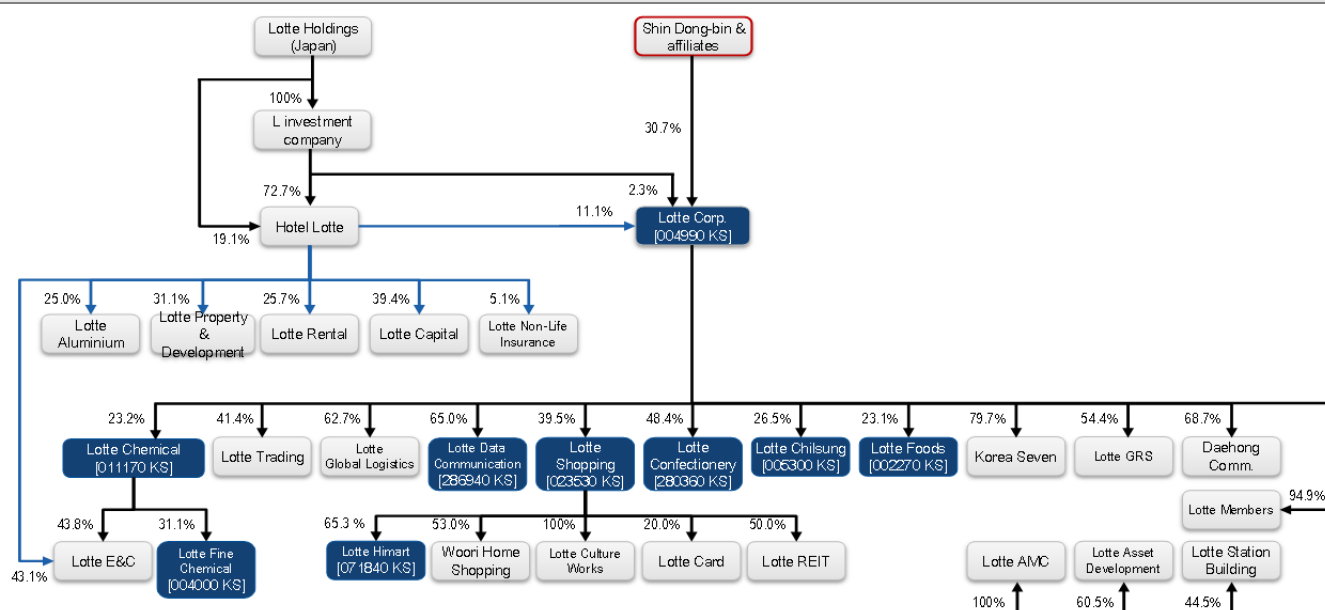
A number of additional transactions have taken place between Lotte Corp. and group affiliates in order to: 1) address co-investment issues; 2) fulfill holding company requirements; and 3) prevent circular shareholdings.

Table 5. Lotte Group's holding company conversion

	Step 1	Step 2	Step 3	Step 4
Date	10/12/17	4/1/2018	6/21/18	10/10/18
Purpose	Establishment of Lotte Corp.	Complete unwinding of the group's circular/cross-shareholdings	Raising stakes in food affiliates to meet the subsidiary ownership requirements under the MRFTA	Bringing the chemical business under the holding company structure
Notes	Merged the investment units spun off from Lotte Confectionery, Lotte Shopping, Lotte Chilsung, and Lotte Foods, in order to convert to a holding company structure	Eight circular shareholdings and three cross holdings were fully untied via mergers with spun-off entities	Exchanged shares with Lotte Confectionery and Lotte Chilsung Beverage through tender offers	Expanded the company's business portfolio and boosted the value of the holding company by adding other affiliates to the holding company structure

Source: Lotte Corp., Mirae Asset Daewoo Research

Figure 13. Lotte Group's corporate structure (current)



Source: DART, Mirae Asset Daewoo Research

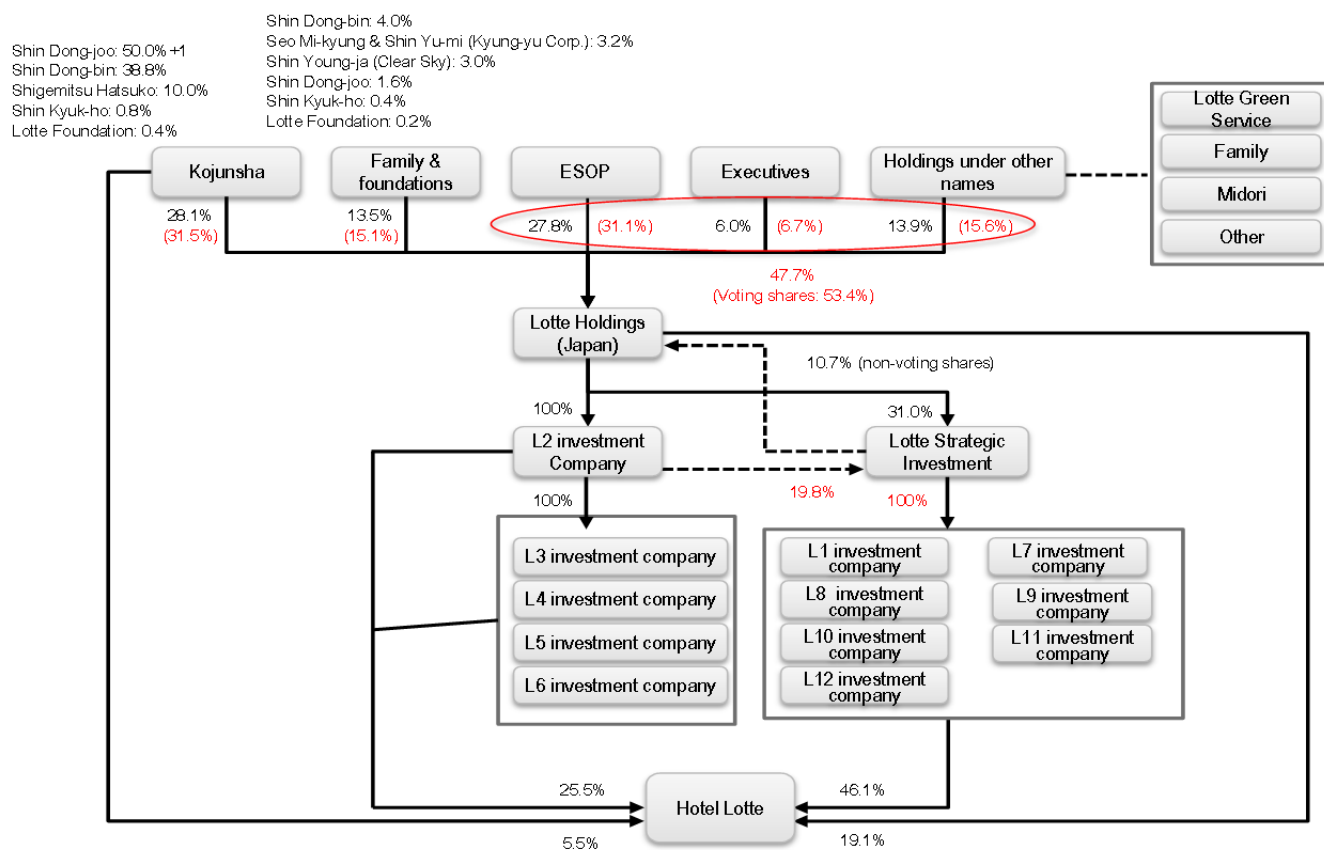
Table 6. Lotte Corp's major shareholders

(% , Wbn)

Shareholder	No. of shares	Stake	Value
Hotel Lotte	11,644,662	11.1	440.2
Lotte Aluminium	5,313,478	5.1	200.8
Lotte Holdings	2,613,965	2.5	98.8
L2 investment company	1,548,547	1.5	58.5
Hotel Lotte Busan	989,749	0.9	37.4
L12 investment company	823,865	0.8	31.1
Subtotal (1)	22,934,266	21.9	866.9
Shin Dong-bin	12,283,541	11.7	464.3
Shin Kyuk-ho	3,245,425	3.1	122.7
Shin Young-ja	2,352,422	2.2	88.9
Shin Dong-joo	171,673	0.2	6.5
Zhang An	77,037	0.1	2.9
Shin Yu-mi	42,254	0.0	1.6
Jang Sun-yoon	801	0.0	0.0
Lotte Scholarship Foundation	3,394,589	3.2	128.3
Lotte Foundation for Arts	90,869	0.1	3.4
Lotte Samdong Welfare Foundation	54,807	0.1	2.1
Subtotal (2)	21,713,418	20.7	820.8
(1) + (2)	44,647,684	42.6	1,687.7
Treasury shares	34,103,935	32.5	1,289.1
Total	104,909,237	100.0	3,965.6

Note: Based on September 17, 2019 closing prices

Source: DART, Mirae Asset Daewoo Research

Figure 14. Lotte Group's Japanese corporate structure

Source: DART, Mirae Asset Daewoo Research

2) Disposal of stakes in financial subsidiaries

Lotte Corp. is currently in the process of selling its stakes in financial subsidiaries and affiliates, including Lotte Card and Lotte Capital to comply with fair trade laws, which prohibit general holding companies from owning shares in financial companies. The company is required to complete the stake disposals by October 2019 before the expiration of the two-year grace period.

Lotte Corp. decided to sell 79.8% of its stake in Lotte Card (93.8%) to MBK Partners for W1.38tr in May 2019 and disposed of the remaining stake (14%) in Lotte Card to Lotte Shopping for W227.7bn in June. In addition, Lotte Corp. decided to sell the 53.5% stake in Lotte Insurance held by non-financial affiliates (such as Hotel Lotte) to JKL Partners for W373.4bn. The deals will be closed once the FSC approves the changes in majority shareholder ownership (which is expected in October according to news reports).

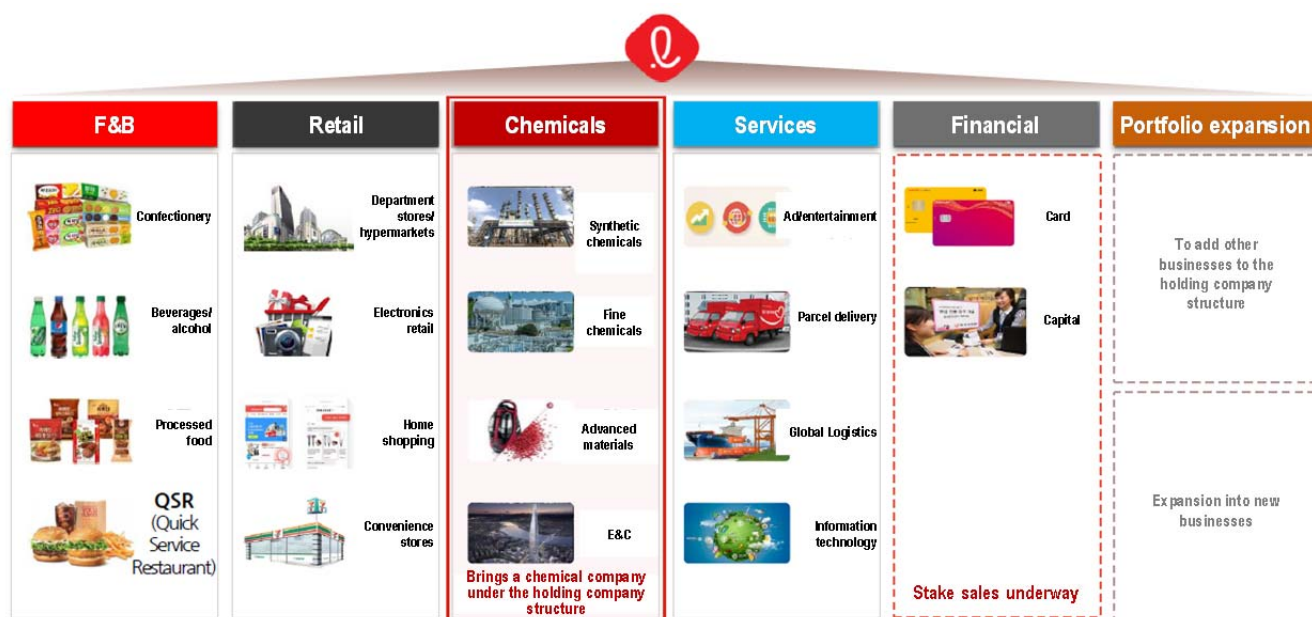
Meanwhile, Lotte Corp. is also required to divest its stake in Lotte Capital by October 11, 2019, but detailed plans have yet to be announced. Due to time constraints, there is reportedly a growing likelihood of Lotte Corp. selling its stake in Lotte Capital to Japan-based Lotte Holdings rather than outside buyers.

Table 7. Disposal of stakes in financial subsidiaries

	Lotte Card	Lotte Insurance	Lotte Capital
Stakes subject to disposal	79.8% held by Lotte Corp.	53.5% (18.7% held by Hotel Lotte; 7.1% held by Lotte Station Building)	25.6% stake held by Lotte Corp.
Disposal price	W1.38tr	W373.4bn	-
Buyer	MBK Partners/Woori Bank consortium	JKL Partners	Japan-based Lotte Holdings (expected)
Date of agreement	May 24 2019	May 24 2019	-
Other	The deal-closing date will be confirmed once the FSC approves the changes in majority shareholder ownership (slated for October 2 nd) and agreements between related parties are reached.		Expiration of the grace period on October 11, 2019

Source: DART, Mirae Asset Daewoo Research

Figure 15. Changes in Lotte Corp's business portfolio



Source: Lotte Corp., Mirae Asset Daewoo Research

II. Group-level issues

1. Five-year investment plan (W50tr)

In October 2018, Lotte Group announced a plan to invest a total of W50tr across all of its domestic and overseas businesses through 2023. With the goal of achieving a group-wide digital transformation, Lotte Group is seeking to better serve customers and find new growth opportunities in the rapidly changing business environment. Specifically, the group plans to strengthen its competitiveness and identify future growth engines in retail and chemicals, which it considers the two pillars of growth.

① Retail: Strengthening online operations

On the retail front, the group's first priority is building the largest e-commerce platform in Korea. In May 2018, it unveiled a plan to invest W3tr in its online retail operations over the next five years, including 1) W500bn to integrate the group's online shopping malls and develop an online payment system, 2) W1tr to build an integrated logistics system, and 3) W1.5tr for marketing. Lotte Group has already established an e-commerce division to consolidate its eight online shopping malls (e.g., Lotte Department Store, Lotte Mart, Lotte Home Shopping, etc.) and the online sub-units of its offline businesses. Going forward, the group aims to increase its online revenue from W7tr (18% revenue share) in 2018 to W20tr (30%) in 2022.

② Food

In the food business, Lotte Group will focus on developing market-leading products to meet ever-changing customer needs. To that end, the group will increase investments in AI to proactively analyze emerging food trends and develop new products.

③ Chemicals

Lotte Group will aim to achieve economies of scale and enhance cost competitiveness through steady investments in domestic production bases (Yeosu, Ulsan, and Daesan). It also plans to make large-scale capex investments overseas.

④ Tourism/services

Lotte Group will strive to increase its brand value through steady business expansion at home and abroad. Specifically, the group will strengthen its Indonesian and Vietnamese operations, tap into new markets, and seek M&A opportunities.

Table 8. Lotte Group's five-year investment plan (2019-23)

(Wbn)

	Details	%	Amount
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	<ul style="list-style-type: none"> • Steady domestic and overseas expansion 	25%	12.5
Total		100%	50.0

Source: Lotte Group, Mirae Asset Daewoo Research

2. Group-wide digital transformation

Lotte Group plans to build the One Lotte Smart Ecosystem (smart factories, smart logistics, and smart retail) to sharpen its competitive edge and achieve sustainable growth.

① Smart factories

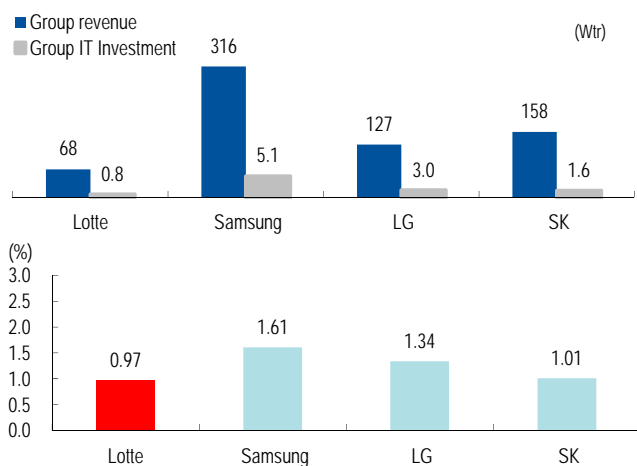
A smart factory combines all elements of production (from design/development to logistics) with information and communication technologies to make the manufacturing process more intelligent and improve product quality. An increasing number of manufacturers are harnessing the Internet of Things (IoT) to digitalize their factories.

Lotte Group has likewise embarked on an initiative to introduce smart manufacturing in its subsidiaries, including Lotte Chilsung and Lotte Confectionery in F&B, Lotte Chemical and Lotte Fine Chemical (004000 KS/CP: W46,300) in chemicals, and Lotte Aluminium in manufacturing. Through 2022, over W140bn will be invested to convert 88 factories (48 domestic and 40 overseas) into smart factories (W36bn in 2019-20; W104bn in 2021-22).

② Smart logistics

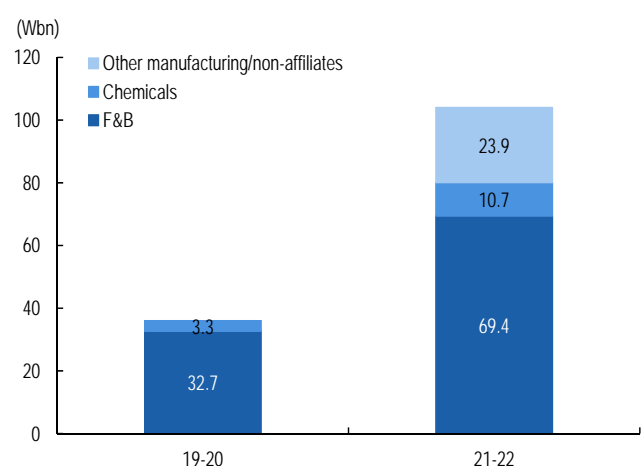
Smart logistics is an integrated, IT-based system that enables real-time logistics control, management, and operation. Lotte Group has consolidated its logistics operations (Lotte Global Logistics and Lotte Logistics) and plans to build a smart logistics service center that will encompass system development, maintenance, and operations.

Figure 16. IT investments by conglomerate



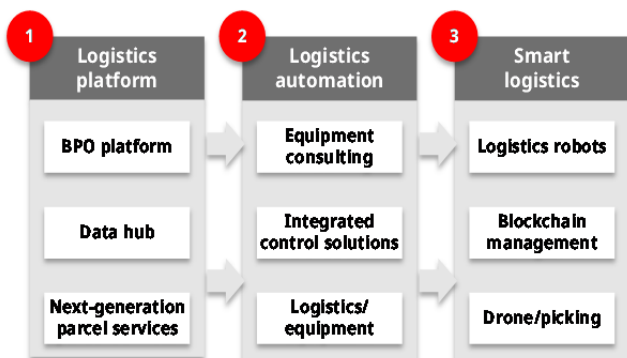
Source: Lotte Data Communication, Mirae Asset Daewoo Research

Figure 17. Lotte Group's smart factory investment plan



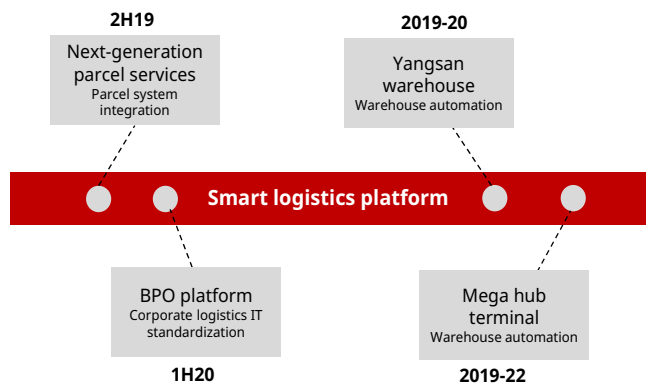
Source: Lotte Data Communication, Mirae Asset Daewoo Research

Figure 18. Lotte Group's smart logistics project roadmap (1)



Source: Lotte Data Communication, Mirae Asset Daewoo Research

Figure 19. Lotte Group's smart logistics project roadmap (2)



Source: Lotte Data Communication, Mirae Asset Daewoo Research

③ Smart retail

Smart retail describes a set of smart technologies that are designed to give the consumer a faster, safer, smarter experience when shopping. As part of its efforts to build a smart retail platform, Lotte Group is integrating and digitalizing its online and offline retail channels. Looking ahead, the group should be able to ensure sustainable growth through omni-channel retail and conversion to smart stores/convenience stores.

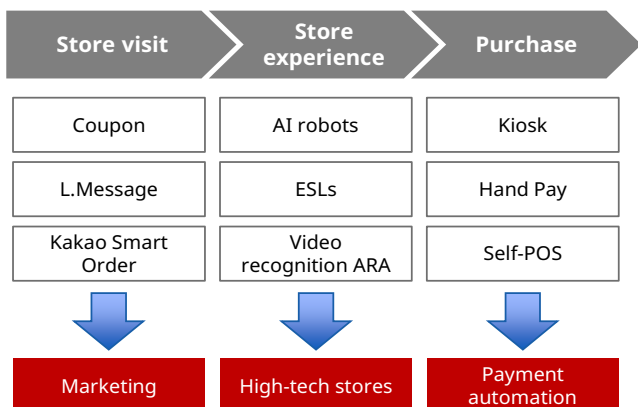
In the small-sized store segment, Lotte has already opened a 13th smart convenience store and one Food Dream store (a premium convenience store brand). Moreover, it is incorporating IoT into its business model to operate cashier-less stores and improve delivery services. In the large-sized store segment, the group plans to offer personalized product recommendations (through integrated online/offline data analysis) and digital transformation-based store management services.

In addition, the group will use voice commerce technology, which allows customers to get recommendations and buy items using voice commands. Voice commerce is widely viewed as one of the next big things in e-commerce.

④ Smart business

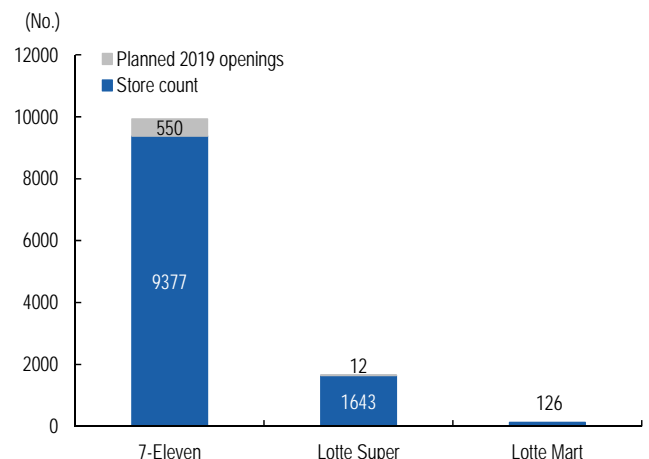
Lotte Group plans to build an AI customer relationship management (CRM) center and introduce AI robotic process automation (RPA) to efficiently integrate online/offline data and generate new business opportunities through AI and big data analysis.

Figure 20. Lotte Group's smart retail platform



Source: Lotte Data Communication, Mirae Asset Daewoo Research

Figure 21. Lotte Group's retail store status



Source: Lotte Data Communication, Mirae Asset Daewoo Research

Figure 22. CRM integration plan



Source: Lotte Data Communication, Mirae Asset Daewoo Research

Figure 23. AI RPA plan

Clients	Application	Time frame
Lotte Corp., etc.	RPA: Streamlining simple, repetitive tasks (nine companies)	1H19
Lotte Confectionery	LCIA: AI-based trend forecasting system utilizing social networking services, POS data, and other info (weather, age, regions, etc.) AI-based food trend analysis (Pepero, Lotte Butter Biscuits)	August 2018
Lotte Corp.	AI-assisted hiring: Plagiarism check (10 days → Eight hours)	July 2018
Lotte Department Store	LOSA: AI-based shopping advisor *Won a prize at the World Retail Awards (UK) in April 2018	January 2018
7-Eleven	VENY: AI robot Responses to customer queries and payment services	June 2017

Source: Lotte Data Communication, Mirae Asset Daewoo Research

3. IPO of Lotte REIT

1) IPO plan

Lotte Group plans to list Lotte REIT in late October. Lotte REIT is a real estate investment company that is obligated to distribute more than 90% of its distributable income (rental income and capital gains from the sale of properties) to shareholders.

Lotte Shopping transferred the Lotte Department Store Gangnam branch to Lotte REIT as an in-kind contribution (₩424.9bn) for a 100% stake in the latter. Lotte Shopping will remain the largest shareholder with a 50% stake post-IPO. Lotte REIT plans to use the IPO proceeds and loans to acquire three Lotte Department Store locations (Guri, Gwangju and Changwon), two Lotte Outlet locations (Daegu Yulha and Cheongju), and four Lotte Mart locations (Daegu Yulha, Cheongju, Uiwang, and Jangyu). Lotte REIT also has the right of first offer for Lotte Shopping's remaining stores.

Notably, Lotte REIT minimizes vacancy risks through long-term master leases with Lotte Shopping, and the triple net structure of these leases (whereby the tenant pays all property expenses, including real estate taxes, building insurance, and maintenance) reduces its operating burden. Lotte REIT also minimizes the risk of lease expiry concentration by dividing lease periods into three tranches (nine, 10, and 11 years).

Lotte REIT is expected to offer a stable annual dividend yield of around 6% and make interim and year-end dividend payments, supported by rental income (leases to increase 1.5% annually).

Table 9. Lotte REIT's IPO outline

IPO details	Notes
No. of shares to be issued	85,984,442 common shares (institutional investors 65%, retail subscribers 35%)
Assumed price of new shares	₩4,750-5,000
Total value of new shares	₩408.4-429.9bn
Book building	9/23/2019 – 10/2/2019
Expected IPO date	End-October 2019
Largest shareholder on a post-IPO basis	Lotte Shopping (50% stake, 85,984,442 shares), lock-up period: 1 year from May 2019
Dividend payout	For periods ending in June and December

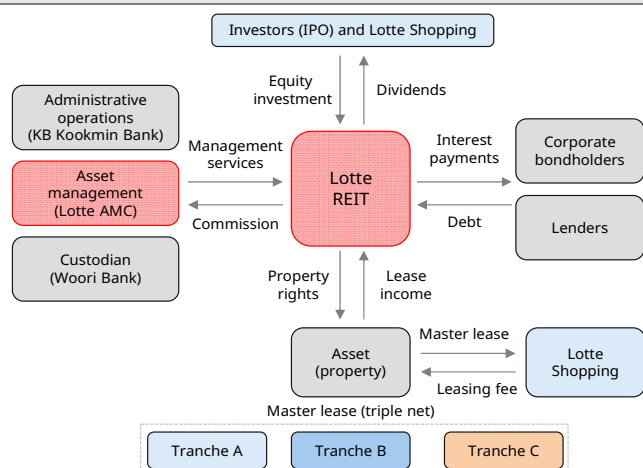
Source: DART, Mirae Asset Daewoo Research

Table 10. Lotte REIT: Target dividend yield

₩4,750		2019 year-end	2020 interim	2020 year-end	2021 interim	₩5,000		2019 year-end	2020 interim	2020 year-end	2021 interim
Expected target dividend yield	IPO investors	10.57%	6.62%	6.66%	6.75%	Expected target dividend yield	IPO investors	10.11%	6.35%	6.39%	6.48%
	Lotte Shopping	3.35%	6.29%	6.33%	6.41%		Lotte Shopping	3.37%	6.35%	6.39%	6.48%

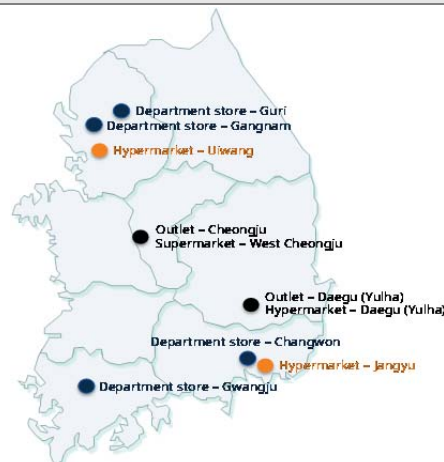
Source: DART, Mirae Asset Daewoo Research

Figure 24. Lotte REIT: Management structure



Source: DART, Mirae Asset Daewoo Research

Figure 25. Lotte REIT: Regional asset distribution



Source: DART, Mirae Asset Daewoo Research

2) Lotte Shopping to raise funding for new business investments

Lotte Shopping is set to raise more than W1tr in cash by selling its assets to Lotte REIT. Lotte Shopping is likely to use the proceeds from asset securitization to invest in new businesses (e.g., online business), drive digital transformation, and repay corporate debt.

In August, Lotte Shopping announced its plan to hand over three Lotte Department Store locations (Guri, Gwangju, and Changwon), two Lotte Outlet locations (Daegu Yulha and Cheongju), and four Lotte Mart locations (Daegu Yulha, Cheongju, Uiwang, and Jangyu) to Lotte REIT following the latter's IPO.

This plan enables Lotte Shopping to finance its new business investments without having to sell its real estate assets to third parties, all while ensuring stable store operation.

Notably, Lotte Shopping is seeking to respond to the fast-changing retail environment and strengthen its competitiveness through innovations in e-commerce logistics, specifically creating a seamless shopping experience across online and offline channels and expanding same-day and 24-hour delivery services.

Table 11. Lotte Shopping-Lotte REIT real estate contracts

(Wbn)

Stores	Price	Leased area (m²)	Type	Lease deposit	Monthly lease payments (estimate)	Lease period	Annual lease increase	Overhead
Lotte Department Store Changwon	246.8	Buildings: 216,694.29 Land: 54,343.40	Tranche A	21.8	1.8	Nine years	1.5%	Triple net leases: Tenants pay all property expenses (real estate taxes, building insurance, and maintenance)
Lotte Mart Uiwang	137.6							
Lotte Mart Jangyu	57.5							
Lotte Department Store Guri	177.3	Buildings: 261,604.26 Land: 57,741.40	Tranche B	24.9	2.1	10 years		
Lotte Outlet Cheongju	139.2							
Lotte Mart Cheongju								
Lotte Outlet Daegu Yulha	170.2							
Lotte Mart Daegu Yulha		Buildings: 160,480.69 Land: 21,358.70	Tranche C	27.7	2.3	11 years		
Lotte Department Store Gangnam	424.9							
Lotte Department Store Gwangju	134.4							
Total	1,487.8			74.4	6.2	-	-	-

Source: DART, Mirae Asset Daewoo Research

3) Lotte AMC

Established in March 2019 as a wholly owned subsidiary of Lotte Corp., Lotte AMC receives fees from Lotte REIT for asset management services.

Lotte AMC is responsible for structuring and running the asset portfolio of Lotte REIT. Lotte AMC's performance is reflected in Lotte Corp.'s consolidated financials, reinforcing the latter's cash flow.

Table 12. Lotte REIT-Lotte AMC: Asset management fees

Type	Payee	Item	Rate	Period	Note
Asset management fees	Lotte AMC	Basic fees	0.2% of acquisition price, calculated from the date of the asset rights transfer to the asset management company to the date of the rights transfer to the buyer	Within 7 days from the invoice date after the submission of the audited financial statements for the period ended	Calculated on a daily basis
		Acquisition fees	0.4% of the acquisition price	Within 7 days from the invoice date after the transfer of the right	-
		Disposal fees	1. Basic fees: 0.7% of disposal price 2. Performance fees: 10% of capital gains from asset sale	Within 7 days from the invoice date after the closure of the deal	-

Source: DART, Mirae Asset Daewoo Research

III. Shareholder return policy

Lotte Group's efforts to increase shareholder value

1) Management overhaul and corporate governance restructuring

Lotte Group announced its management overhaul plan in August 2015 and corporate governance restructuring plan in October 2016. Except for the delayed IPO of Hotel Lotte, Lotte Group has made significant progress on these plans by unwinding its circular shareholding structure, converting to a holding company structure, and improving management transparency.

2) Stronger shareholder return policy

During its conversion to a holding company structure via the spin-off/merger of Lotte Confectionery, Lotte Shopping, Lotte Chilsung, and Lotte Foods in 2017, Lotte Group announced shareholder-friendly policies for Lotte Corp. and the four affected companies. Lotte Group intends to enhance shareholder value by gradually raising the dividend payout ratio up to 30% and making interim dividend payments.

First, Lotte Corp. improved its net asset value (NAV) per share by cancelling 10% of its outstanding shares (or 25% of its treasury stock), and enhanced its dividend payout capacity by reclassifying W4.5tr in capital reserves as earnings surplus. Lotte Corp. has distributed interim dividend of W300 per share since 1H19.

Figure 26. Lotte Group's governance restructuring plan (October 2016)

	Details
Improving transparency	<ul style="list-style-type: none"> Operating the compliance committee under direct supervision of the president Affiliates with asset value of W1tr or higher
	<ul style="list-style-type: none"> Hotel Lotte IPO Improving management transparency and corporate governance
	<ul style="list-style-type: none"> Converting to a holding company structure, and unwinding cross-shareholdings
	<ul style="list-style-type: none"> Reducing group-level policymaking and strengthening management responsibilities of affiliates
Strengthening CSR	<ul style="list-style-type: none"> Shifting from quantitative to qualitative growth Adjusting the Vision 2020 goals
	<ul style="list-style-type: none"> Investing W40tr by 2020 and hiring 70,000 additional employees

Source: Mirae Asset Daewoo Research

Table 13. Shareholder return policies implemented by Lotte Group's key listed companies

	Lotte Holdings	Lotte Confectionery	Lotte Shopping	Lotte Chilsung	Lotte Foods
Governance structure	Conversion to a holding company structure and the unwinding of the circular shareholding→ Improved governance structure and greater efficiency of the operating companies				
Dividend policy	Interim dividend of W300 (2019)	Gradual increase in dividend payout ratio (up to 30%) and interim dividend payouts			
Stock split	-	W5,000→W500 (2016)	-	W5,000→W500 (2019)	-
Treasury shares	Cancellation of 10% (11,657 treasury stocks (10% of outstanding shares))	-	-	-	-
IPO	Lotte Data Communication's IPO	-	IPO plans for Lotte Culture Works and Lotte REITs	-	-

Source: DART, Mirae Asset Daewoo Research

Lotte Corp. (004990 KS)

Holding company conversion almost complete; Re-rating in the cards

Conglomerates

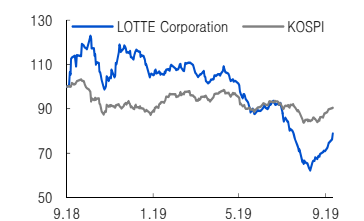
(Initiate)	Buy
Target Price (12M, W)	52,000
Share Price (09/17/19, W)	37,800
Expected Return	38%

OP (19F, Wbn)	188
Consensus OP (19F, Wbn)	-

EPS Growth (19F, %)	198.2
Market EPS Growth (19F, %)	-28.1
P/E (19F, x)	7.3
Market P/E (19F, x)	13.1
KOSPI	2,062.33

Market Cap (Wbn)	3,966
Shares Outstanding (mn)	106
Free Float (%)	24.9
Foreign Ownership (%)	12.3
Beta (12M)	0.98
52-Week Low	29,800
52-Week High	58,900

(%)	1M	6M	12M
Absolute	26.8	-25.3	-30.6
Relative	18.5	-21.2	-22.5



Initiate coverage with Buy and TP of W52,000

We initiate our coverage on Lotte Corp. with a Buy rating and target price of W52,000. Our target price is based on a sum-of-the-parts (SOTP) valuation, consisting of brand royalty income, the value of real estate investments, and the value of subsidiary stakes.

We estimate that subsidiary stakes represent roughly 75% (45% for listed subsidiaries and 30% for unlisted subsidiaries) of Lotte Corp.'s total asset value. Of this, Lotte Chemical and Lotte Shopping are the biggest contributors, at 19% and 14%, respectively. Indeed, Lotte Corp.'s share price has shown a strong correlation with the share prices of Lotte Chemical (+0.91) and Lotte Shopping (+0.97) since the start of 2019.

At present, Lotte Corp. is trading at a 49% discount to its estimated NAV per share.

Investment points: Holding company conversion almost complete; Subsidiary stake value to trigger re-rating

1) Lotte Corp. to meet holding company requirements and clear uncertainties with financial affiliate stake sales

Lotte Corp. is currently in the process of selling its stakes in financial affiliates, including Lotte Card and Lotte Capital, to comply with fair trade laws, which prohibit general holding companies from owning shares in financial companies. The company is required to complete the stake disposals by October 11th. On September 17th, media reports indicated that the FSC is set to approve the MBK Partners/Woori Bank consortium as Lotte Card's majority shareholder on October 2nd. There are also reports that Lotte Corp. plans to sell its 25.6% stake in Lotte Capital to Japan-based Lotte Holdings. If the stake sales are completed within the deadline, we believe this would be positive to Lotte Corp., as it would allow the company to meet its holding company requirements and clear uncertainties. We believe the company will use the proceeds from the stake sales to pay down its short-term borrowings, which have increased following the acquisition of Lotte Chemical shares.

2) Lotte REIT's IPO to pave the way for new business opportunities for Lotte Shopping and Lotte Data Communication

Lotte Group plans to list Lotte REIT, which owns 10 Lotte Shopping stores, in late October. Lotte Shopping is expected to raise around W1tr through the asset securitization and plans to invest the proceeds in new businesses, including online operations. Meanwhile, Lotte Data Communication, which is the group's only IT service provider, is likely to see new business opportunities from the IT investments and digital transformation push by major group affiliates, such as Lotte Shopping. As both Lotte Shopping and Lotte Data Communication gain new business opportunities, this could lead to a rise in the value of Lotte Corp.'s stakes in the two companies (40% and 65%, respectively), triggering a valuation re-rating.

3) IPO of unlisted subsidiaries to boost stake value

We expect Lotte Corp.'s unlisted subsidiaries, such as Korea Seven and Lotte GRS (Lotteria), to follow in the footsteps of Lotte Data Communication and pursue IPOs. In the process, the value of Lotte Corp.'s holdings could be re-rated higher.

FY (Dec.)	12/15	12/16	12/17	12/18	12/19F	12/20F
Revenue (Wbn)	2,258	2,248	1,869	7,271	8,955	9,204
OP (Wbn)	144	128	-7	98	188	210
OP margin (%)	6.4	5.7	-0.4	1.3	2.1	2.3
NP (Wbn)	75	70	469	185	551	663
EPS (W)	2,117	1,965	10,602	1,746	5,207	6,265
ROE (%)	3.0	2.8	11.0	2.8	7.5	8.3
P/E (x)	30.5	25.8	6.1	30.2	7.3	6.0
P/B (x)	0.9	0.7	0.7	0.6	0.4	0.4
Dividend yield (%)	0.7	0.9	0.0	1.5	2.1	2.1

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

Valuation

Initiate coverage with Buy and TP of W52,000

We initiate our coverage on Lotte Corp. with a Buy rating and target price of W52,000, which is based on a SOTP valuation.

Table 14. Valuation

(Wbn, W, %)

	Value	Note
Operating value (1)	1,325	
In-house businesses	0	Pure holding company
Brand royalty income	1,111	Based on royalty rate of 15bps; applied 15.0x after reflecting costs
Real estate	214	
Value of investment assets (2)	8,229	
Listed subsidiaries	4,868	Based on market value
Unlisted subsidiaries	3,362	Based on book value and fair value
Total asset value (3)=(1)+(2)	9,555	
Net borrowings (4)	3,064	As of end-2Q19
Treasury stock (5)	1,303	Common shares 32.5%; preferred shares 28.4%
NAV (6)=(3)-(4)-(5)	7,794	
Market cap	4,015	As of Sep. 17, 2019
Discount to NAV	48.5%	
No. of shares ('000 shares)	105,897	Common and preferred
NAV per share	73,599	
Theoretical target price	51,519	30% discount to per-share NAV
Target price	52,000	
Current price	37,800	Based on the Sep. 17, 2019 closing price
Upside potential	37.6	

Source: Mirae Asset Daewoo Research

Table 15. Value of investment securities

(%, Wbn, W)

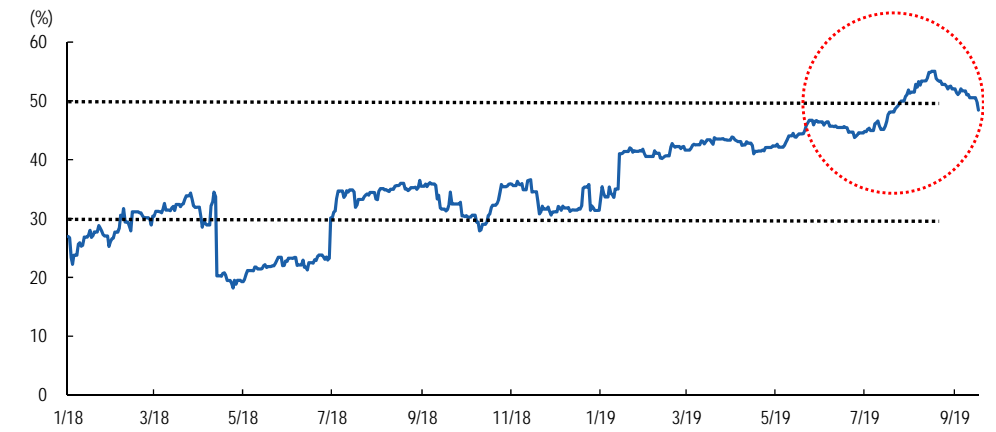
	Stake	Book value	Current price	Value	Notes
Listed subsidiaries				4,868	Market value
Lotte Shopping	40.0	2,492	137,500	1,556	
Lotte Confectionery	48.4	547	149,000	463	
Lotte Chilsung	26.5	347	141,000	299	
Lotte Chilsung (preferred)	8.4	6	74,400	5	
Lotte Foods	23.1	201	454,500	119	
Lotte Chemical	23.2	2,228	252,500	2,011	
Lotte Data Communication	65.0	349	41,500	415	
Unlisted subsidiaries		2,395		3,362	
Korea Seven	79.7%	269		462	2019F NP; target P/E of 15x
Lotte Global Logistics	44.6%	278		278	
Lotte Asset Development	60.5%	147		147	
Lotte Station Building	44.5%	142		142	
Daehong Communications	68.7%	106		106	Book value
Lotte GRS	54.4%	34		34	
Other		305		305	
Lotte Card	93.8%	1,000		1,609	Based on MBK Partners-Woori Bank Consortium's purchase price
Lotte Capital	25.6%	113		278	Based on recent stake sale price

Note: Based on September 17, 2019 closing prices

Source: Mirae Asset Daewoo Research

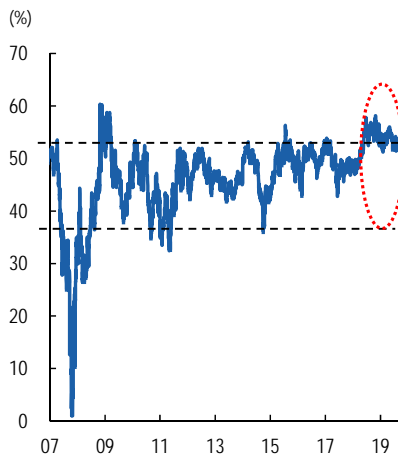
We estimate that subsidiary stakes represent roughly 75% (45% for listed subsidiaries and 30% for unlisted subsidiaries) of Lotte Corp.'s total asset value. Of this, Lotte Chemical and Lotte Shopping are the biggest contributors, at 19% and 14%, respectively. Indeed, Lotte Corp.'s share price has shown a strong correlation with the share prices of Lotte Chemical (+0.91) and Lotte Shopping (+0.97) since the start of 2019.

Figure 27. Lotte Corp.'s NAV discount trend



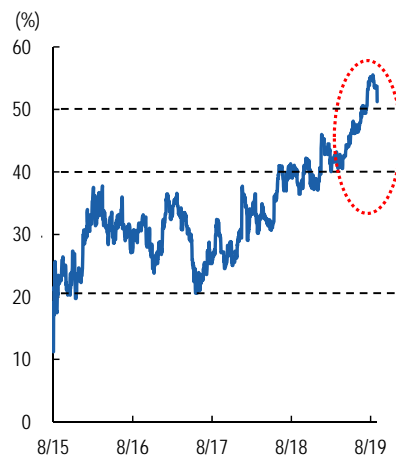
Source: WISEfn, Mirae Asset Daewoo Research

Figure 28. LG Corp.'s NAV discount trend



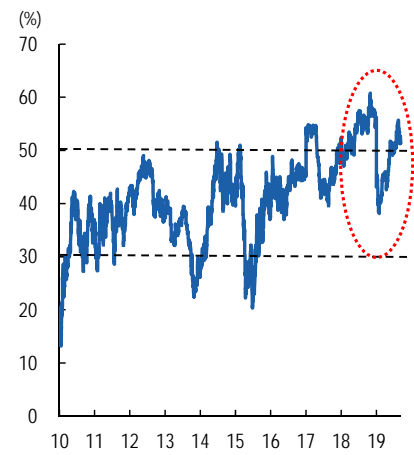
Source: WISEfn, Mirae Asset Daewoo Research

Figure 29. SK Holdings' NAV discount trend



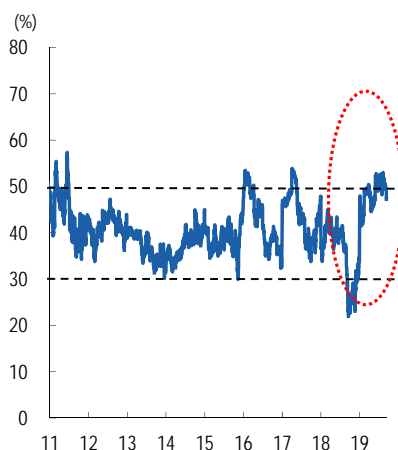
Source: WISEfn, Mirae Asset Daewoo Research

Figure 30. Hanwha Corp.'s NAV discount trend



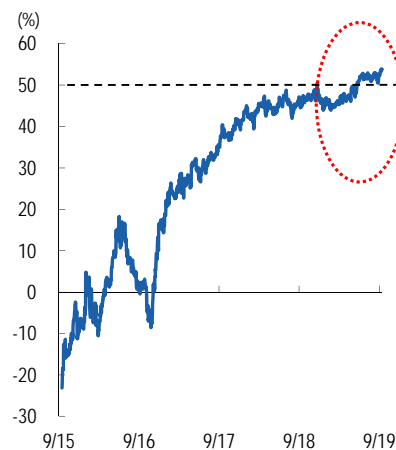
Source: WISEfn, Mirae Asset Daewoo Research

Figure 31. Doosan Corp.'s NAV discount trend



Source: WISEfn, Mirae Asset Daewoo Research

Figure 32. Samsung C&T's NAV discount

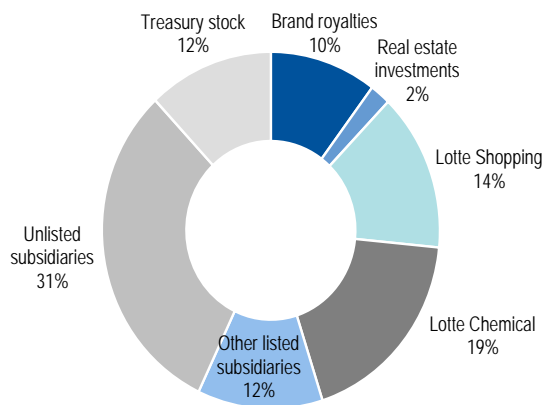


Source: WISEfn, Mirae Asset Daewoo Research

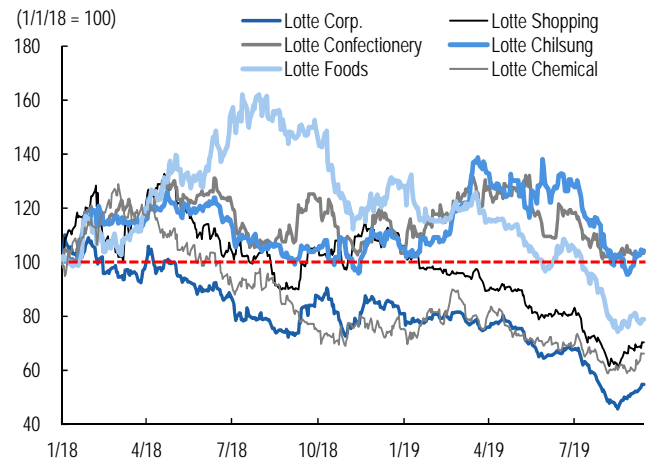
Figure 33. CJ Corp.'s NAV discount trend



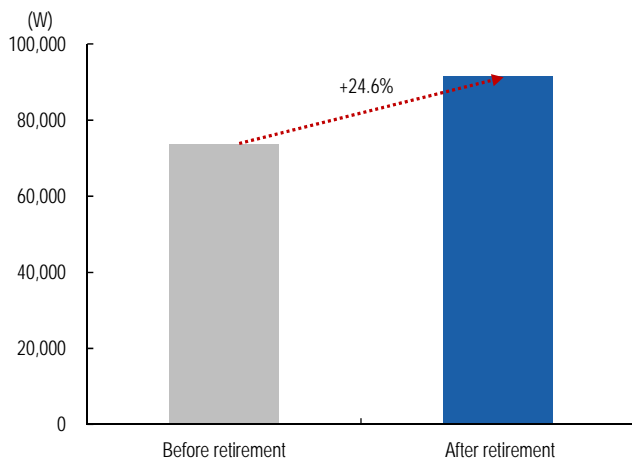
Source: WISEfn, Mirae Asset Daewoo Research

Figure 34. Lotte Corp.'s asset breakdown

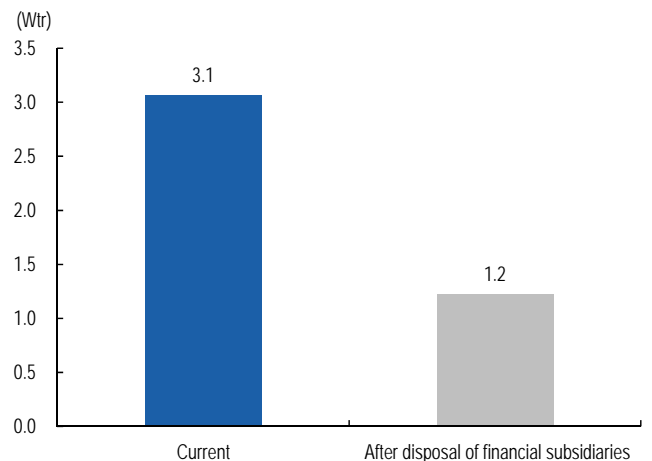
Source: WISEfn, Mirae Asset Daewoo Research

Figure 35. Share performances of Lotte Group's major listed affiliates

Source: WISEfn, Mirae Asset Daewoo Research

Figure 36. Estimated changes in per-share value assuming retirement of all treasury shares (32.5% of total common shares)

Source: Mirae Asset Daewoo Research

Figure 37. Lotte Corp.'s net debt estimates

Note: Based on 2Q19 figure; divestment of Lotte Card and Lotte Capital stakes is underway

Source: Mirae Asset Daewoo Research

Figure 38. Lotte Corp.'s share performance

Source: WISEfn, Mirae Asset Daewoo Research

Earnings outlook

Annual cash inflow of around W400bn

Lotte Corp., which is Lotte Group's pure holding company, generates operating revenue in the form of dividends, brand royalties, and rental income. Lotte Corp., charges subsidiaries royalty payments for the use of its brands, which are determined as a certain percentage of revenue and advertising/promotion expenses. Lotte Corp. receives rental income by leasing out its own buildings to subsidiaries and consultation fees by adding a certain mark-up to the cost of management consulting services. In particular, brand royalty and management consultation fees, which Lotte Corp. can collect even from non-affiliated group companies (e.g., Hotel Lotte), help improve the stability of the firm's cash flow.

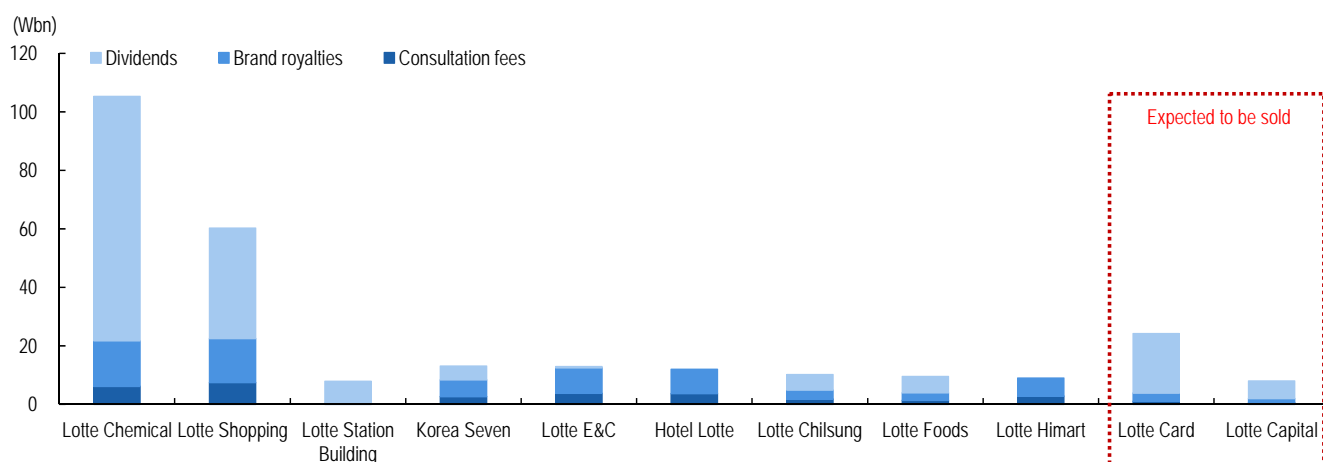
Table 16. Lotte Corp.'s cash flow summary

(Wbn)

	2017 (Oct.-Dec.)	2018	2019F	2020F
Recurring net cash inflow (1)-(2)	-12.8	52.2	-72.1	-18.0
Recurring cash inflow (1)	32.2	263.0	415.4	387.4
Dividends	0.0	94.8	225.1	193.5
Brand royalties	24.1	104.0	105.8	107.7
Rental income	2.2	12.9	14.2	15.1
Management consultation fees	5.9	48.6	65.4	66.0
Joint system revenue	0.0	2.6	4.9	5.1
Recurring cash outflows (2)	45.0	210.8	487.5	405.5
Maintenance (ex- depreciation)	34.4	134.7	156.2	145.5
Corporate income tax	4.7	39.8	164.7	152.2
Dividend payouts	0.0	0.0	57.2	57.2
Investments in tangible/intangible assets	1.9	7.1	2.0	3.7
Net financing expenses	4.0	29.3	107.4	46.9
Net debt	774.5	3,079.3	1,372.3	1,390.4
Cash and cash equivalents	50.5	97.7	195.9	177.8
Short-term debt	825.0	2,830.0	1,221.2	1,221.2
Long-term debt	0.0	347.0	347.0	347.0

Source: DART, Mirae Asset Daewoo Research

Figure 39. Lotte Corp.'s operating revenue breakdown



Note: Based on 2018 dividends

Source: Company data, Mirae Asset Daewoo Research

Table 17. Lotte Corp's quarterly and annual earnings

(Wbn)

	2017	2018					2019F					2020F	3Q19F growth	
		1Q	2Q	3Q	4Q	Annual	1Q	2Q	3QF	4QF	Annual		QoQ	YoY
Revenue	1,869	1,706	1,833	1,861	1,871	7,271	2,034	2,254	2,360	2,307	8,955	9,204	4.7	26.8
Cost of sales	1,374	1,249	1,335	1,369	1,443	5,295	1,438	1,583	1,663	1,623	6,307	6,482	5.1	21.5
Gross profit	495	457	498	592	428	1,976	596	671	697	684	2,648	2,722	3.9	17.7
SG&A expenses	502	451	468	461	398	1,877	581	617	630	632	2,460	2,511	2.2	36.6
Operating profit	-7	6	30	31	31	98	15	55	66	52	188	210	21.8	114.6
Income/loss before income taxes	2,909	-10	478	83	875	1,425	153	52	106	101	412	534	103.7	27.2
Net income/loss before taxes	517	18	-157	77	400	339	69	94	156	139	458	813	66.6	103.2
Income taxes	35	5	-108	-43	49	97	2	14	19	7	42	87	34.0	TTB
Net profit from continuing operations	483	13	-49	120	351	436	67	80	137	132	416	727	72.4	14.2
Net profit from discontinued operations	12	47	9	0	-381	-325	52	59	53	50	214	0	-8.9	-
Net profit	495	60	-40	120	-30	111	119	138	191	182	630	727	37.9	58.6
Net profit attributable to controlling interests	469	63	-41	122	40	185	125	110	162	155	551	663	46.6	32.2

Note: 3Q-4Q19 figures are based on our estimates

Source: DART, Mirae Asset Daewoo Research

Table 18. Quarterly and annual earnings of major subsidiaries

(Wbn, %)

		2017	2018					2019F					2020F	3Q19F growth	
			1Q	2Q	3Q	4Q	Annual	1Q	2Q	3QF	4QF	Annual		QoQ	YoY
Lotte Confectionery	Revenue	405	401	438	458	397	1,695	492	546	591	541	2,169	2,252	8.2	28.8
	OP	8	11	20	31	2	64	15	27	47	24	113	130	70.6	49.4
	OP margin	2.1	2.8	4.6	6.8	0.5	3.8	3.1	5.0	7.9	4.4	5.2	5.8	2.9	1.1
	Net profit	2	2	13	11	-16	9	8	15	28	14	65	84	87.9	157.7
Lotte Data Communication	Revenue	149	184	200	192	236	812	186	216	217	282	902	1,011	0.2	12.8
	OP	5	6	9	7	17	39	6	14	11	19	49	57	-21.0	47.1
	OP margin	3.5	3.1	4.5	3.8	7.1	4.8	3.0	6.3	5.0	6.7	5.4	5.7	-1.3	1.2
	Net profit	2	5	7	5	10	26	5	31	8	15	59	46	-74.2	73.3
Korea Seven	Revenue	3,843	899	1,007	-	-	3,931	918	1,021	1,070	996	4,005	4,049	4.7	-
	OP	43	0	20	-	-	43	3	20	17	16	56	59	-10.6	-
	OP margin	1.1	0.0	2.0	-	-	1.1	0.4	1.9	1.6	1.6	1.4	1.5	-0.3	-
	Net profit	35	1	17	-	-	38	1	11	10	8	30	32	-10.7	-

Note: Korea Seven did not disclose its 3Q-4Q18 earnings.

Source: DART, Mirae Asset Daewoo Research

Table 19. Quarterly and annual earnings of major affiliates

(Wbn, %)

		2017	2018					2019F					2020F	3Q19F growth	
			1Q	2Q	3Q	4Q	Annual	1Q	2Q	3QF	4QF	Annual		QoQ	YoY
Lotte Shopping	Revenue	17,926	4,334	4,413	-	-	17,821	4,447	4,456	4,731	4,480	18,115	18,369	6.2	-
	OP	801	221	87	-	-	597	205	92	192	192	681	747	109.7	-
	OP margin	4.5	5.1	2.0	-	-	3.4	4.6	2.1	4.1	4.3	3.8	4.1	2.0	-
	Net profit	-136	-36	-242	-	-	-545	89	51	61	94	295	325	20.4	-
Lotte Chilsung	Revenue	2,279	523	600	670	554	2,346	575	677	720	581	2,553	2,639	6.2	7.4
	OP	75	9	23	51	2	85	19	46	62	12	139	153	33.6	21.0
	OP margin	3.3	1.6	3.9	7.6	0.3	3.6	3.3	6.8	8.6	2.1	5.5	5.8	1.8	1.0
	Net profit	135	-2	6	26	-78	-48	2	-45	26	4	-12	81	TTB	2.1
Lotte Foods	Revenue	1,819	431	470	496	413	1,811	425	466	508	423	1,822	1,887	8.8	2.3
	OP	66	16	23	27	1	68	9	19	27	4	58	69	47.2	-0.7
	OP margin	3.6	3.7	4.9	5.5	0.3	3.7	2.0	4.0	5.4	0.9	3.2	3.6	1.4	-0.2
	Net profit	95	11	15	18	-1	43	7	15	18	1	41	48	25.3	1.9
Lotte Chemical	Revenue	15,875	4,123	4,330	4,248	3,844	16,545	3,722	4,035	3,956	3,964	15,677	16,504	-1.9	-6.9
	OP	2,930	662	701	504	100	1,967	296	346	356	323	1,321	1,531	2.9	-29.3
	OP margin	18.5	16.1	16.2	11.9	2.6	11.9	7.9	8.6	9.0	8.2	8.4	9.3	0.4	-2.9
	Net profit	2,244	527	555	435	62	1,579	217	260	305	268	1,050	1,279	16.9	-30.0

Note: Lotte Shopping did not disclose its revised 3Q-4Q18 earnings.

Source: DART, Mirae Asset Daewoo Research

Ownership structure

Holding company conversion

In October 2017, Lotte Group established Lotte Corp. by merging the investment units spun off from Lotte Confectionery, Lotte Shopping, Lotte Chilsung, and Lotte Foods, in order to convert to a holding company structure. Since then, Lotte Corp. has taken steps to legally qualify as a holding company under the MRFTA, while overhauling its ownership structure to strengthen its control over subsidiaries.

In April 2018, Lotte Corp. merged with Lotte IT Tech and the investment units spun off from Lotte GRS, Lotte International, Lotte Logistics, Korea Fujifilm, and Daehong Communications, fully unwinding the group's circular/cross-shareholdings and tightening its grip on non-retail/F&B businesses.

In June 2018, Lotte Corp. exchanged shares with Lotte Confectionery and Lotte Chilsung through tender offers, increasing its equity stakes in the two companies and meeting the subsidiary ownership requirements under the MRFTA.

In October 2018, Lotte Corp. acquired a 23.2% stake in Lotte Chemical (7.97mn shares for W2.2tr) from Hotel Lotte and Lotte Property & Development, bringing the chemical business (which contributes a large portion of group profits) under the holding company structure. The move also expanded the company's business portfolio into construction by adding Lotte E&C, a subsidiary of Lotte Chemical, to the holding company structure.

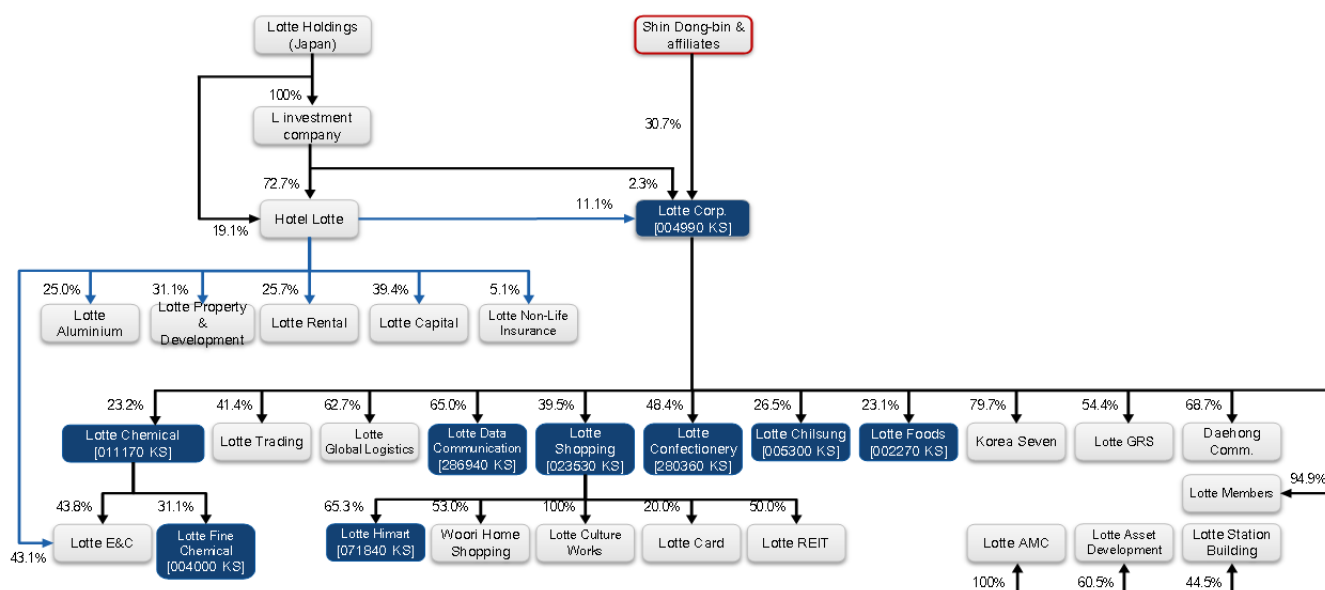
A number of additional transactions have taken place between Lotte Corp. and group affiliates in order to: 1) address co-investment issues; 2) fulfill holding company requirements; and 3) prevent circular shareholdings.

Table 20. Lotte Group's holding company conversion

	Step 1	Step 2	Step 3	Step 4
Date	10/12/17	4/1/2018	6/21/18	10/10/18
Purpose	Establishment of Lotte Corp.	Complete unwinding of the group's circular/cross-shareholdings	Raising stakes in food affiliates to meet the subsidiary ownership requirements under the MRFTA	Bringing the chemical business under the holding company structure
Notes	Merged the investment units spun off from Lotte Confectionery, Lotte Shopping, Lotte Chilsung, and Lotte Foods, in order to convert to a holding company structure	Eight circular shareholdings and three cross holdings were fully untied via mergers with spun-off entities	Exchanged shares with Lotte Confectionery and Lotte Chilsung Beverage through tender offers	Expanded the company's business portfolio and boosted the value of the holding company by adding other affiliates to the holding company structure

Source: Lotte Corp., Mirae Asset Daewoo Research

Figure 40. Lotte Group's corporate structure (summarized)



Source: DART, Mirae Asset Daewoo Research

Table 21. Lotte Corp.'s major shareholders

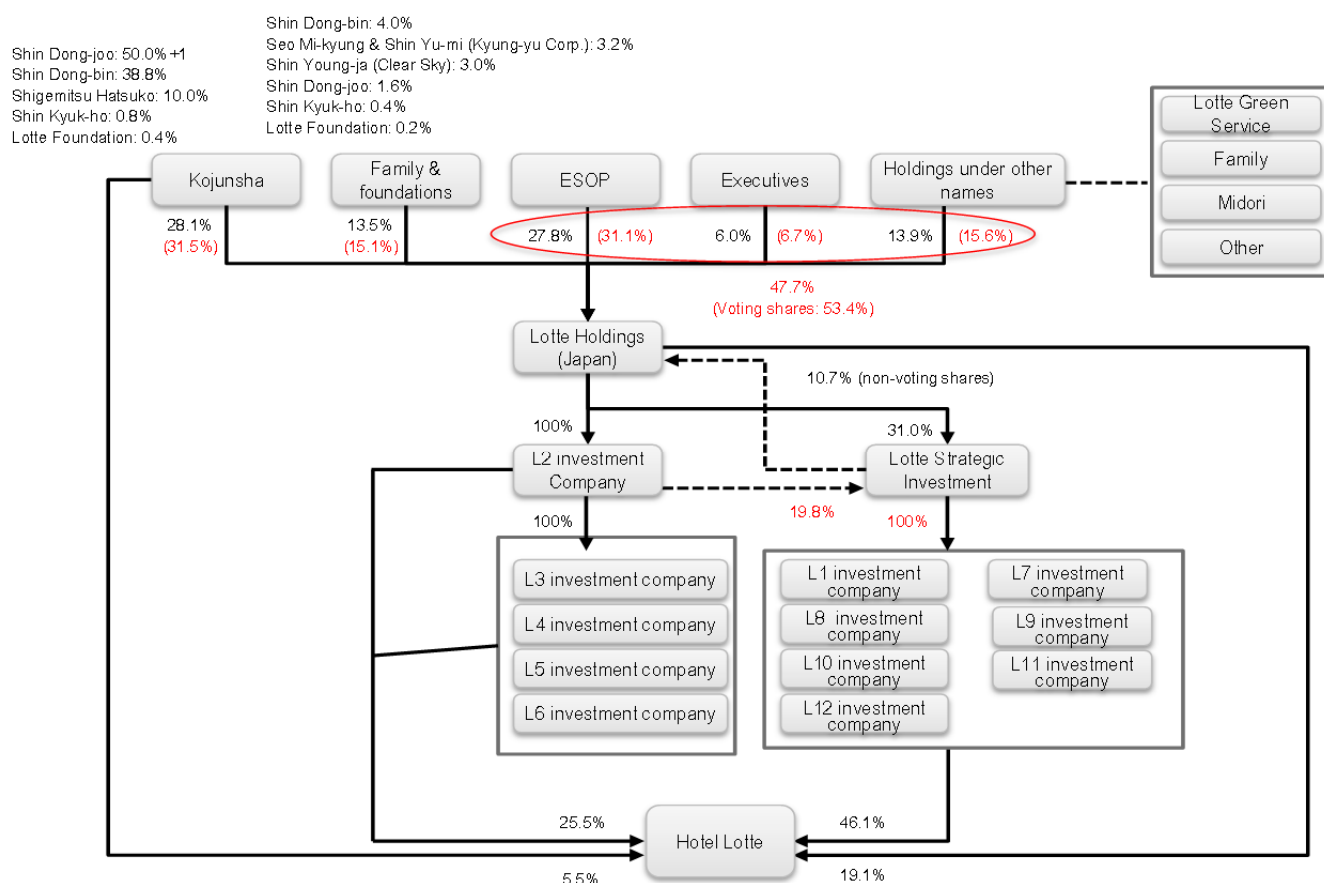
(% , Wbn)

Shareholder	No. of shares	Stake	Value
Hotel Lotte	11,644,662	11.1	440.2
Lotte Aluminium	5,313,478	5.1	200.8
Lotte Holdings	2,613,965	2.5	98.8
L2 investment company	1,548,547	1.5	58.5
Hotel Lotte Busan	989,749	0.9	37.4
L12 investment company	823,865	0.8	31.1
Subtotal (1)	22,934,266	21.9	866.9
Shin Dong-bin	12,283,541	11.7	464.3
Shin Kyuk-ho	3,245,425	3.1	122.7
Shin Young-ja	2,352,422	2.2	88.9
Shin Dong-joo	171,673	0.2	6.5
Zhang An	77,037	0.1	2.9
Shin Yu-mi	42,254	0.0	1.6
Jang Sun-yoon	801	0.0	0.0
Lotte Scholarship Foundation	3,394,589	3.2	128.3
Lotte Foundation for Arts	90,869	0.1	3.4
Lotte Samdong Welfare Foundation	54,807	0.1	2.1
Subtotal (2)	21,713,418	20.7	820.8
(1) + (2)	44,647,684	42.6	1,687.7
Treasury shares	34,103,935	32.5	1,289.1
Total	104,909,237	100.0	3,965.6

Note: Based on September 17, 2019 closing prices

Source: DART, Mirae Asset Daewoo Research

Figure 41. Lotte Group's Japanese corporate structure



Source: DART, Mirae Asset Daewoo Research

Expected to sell stakes in financial subsidiaries

Lotte Corp. is currently in the process of selling its stakes in financial subsidiaries and affiliates, including Lotte Card and Lotte Capital to comply with fair trade laws, which prohibit general holding companies from owning shares in financial companies. The company is required to complete the stake disposals by October 2019 before the expiration of the two-year grace period.

Lotte Corp. decided to sell 79.8% of its stake in Lotte Card (93.8%) to MBK Partners for W1.38tr in May 2019 and disposed of the remaining stake (14%) in Lotte Card to Lotte Shopping for W227.7bn in June. In addition, Lotte Corp. decided to sell the 53.5% stake in Lotte Insurance held by non-financial affiliates (such as Hotel Lotte) to JKL Partners for W373.4bn. The deals will be closed once the FSC approves the changes in majority shareholder ownership (which is expected in October according to news reports).

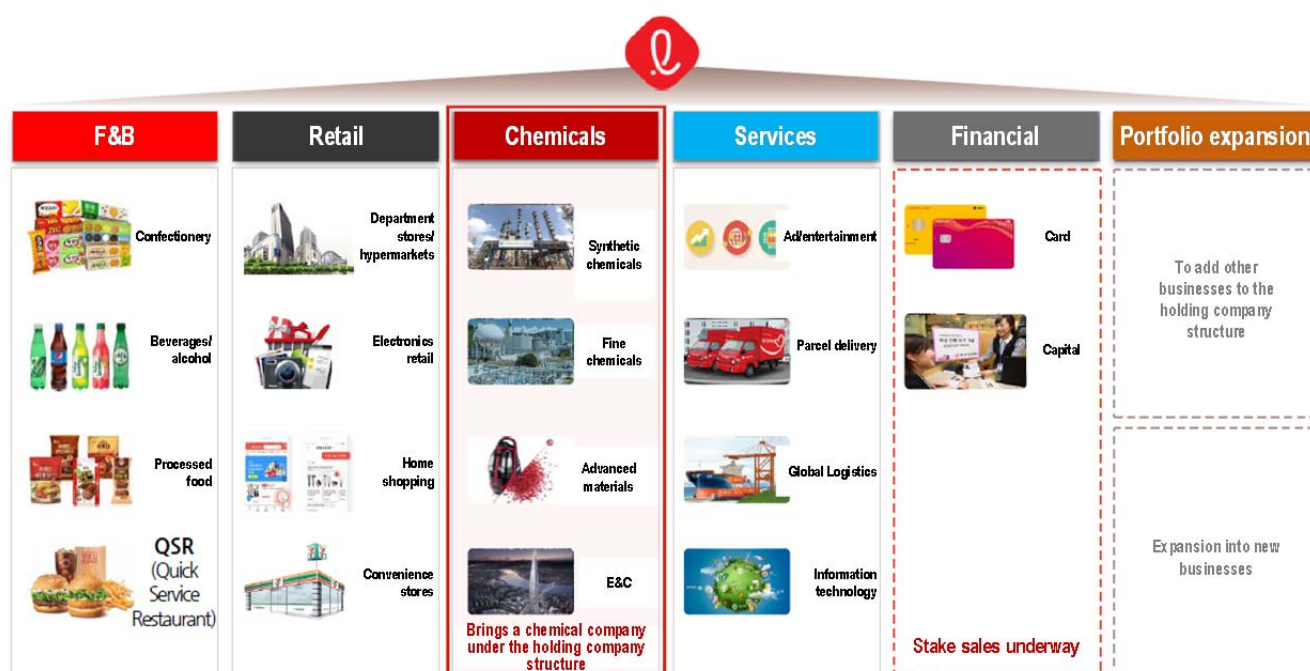
Meanwhile, Lotte Corp. is also required to divest its stake in Lotte Capital by October 11, 2019, but detailed plans have yet to be announced. Due to time constraints, there is reportedly a growing likelihood of Lotte Corp. selling its stakes in Lotte Capital to Japan-based Lotte Holdings rather than outside buyers.

Table 22. Disposal of stakes in financial subsidiaries

	Lotte Card	Lotte Insurance	Lotte Capital
Stakes subject to disposal	79.8% held by Lotte Corp.	53.5% (18.7% held by Hotel Lotte; 7.1% held by Lotte Station Building)	25.6% stake held by Lotte Corp.
Disposal price	W1.38tr	W373.4bn	-
Buyer	MBK Partners/Woori Bank consortium	JKL Partners	Japan-based Lotte Holdings (expected)
Date of agreement	May 24 2019	May 24 2019	-
Other	The deal-closing date will be confirmed once the FSC approves the changes in majority shareholder ownership (slated for October 2nd) and agreements between related parties are reached.		Expiration of the grace period on October 11, 2019

Source: DART, Mirae Asset Daewoo Research

Figure 42. Changes in Lotte Corp's business portfolio



Source: Lotte Corp., Mirae Asset Daewoo Research

Lotte Corp. (004990 KS/Buy/TP: W52,000)

Comprehensive Income Statement (Summarized)

(Wbn)	12/17	12/18	12/19F	12/20F
Revenue	1,869	7,271	8,955	9,204
Cost of Sales	1,374	5,295	6,307	6,482
Gross Profit	495	1,976	2,648	2,722
SG&A Expenses	502	1,877	2,460	2,511
Operating Profit (Adj)	-7	98	188	210
Operating Profit	-7	98	188	210
Non-Operating Profit	524	241	270	603
Net Financial Income	-5	-45	-115	-18
Net Gain from Inv in Associates	2,909	1,425	412	534
Pretax Profit	517	339	458	813
Income Tax	35	-97	42	87
Profit from Continuing Operations	483	436	416	727
Profit from Discontinued Operations	12	-325	214	0
Net Profit	495	111	630	727
Controlling Interests	469	185	551	663
Non-Controlling Interests	26	-74	78	63
Total Comprehensive Profit	335	30	702	727
Controlling Interests	314	105	632	626
Non-Controlling Interests	21	-75	70	100
EBITDA	71	411	770	700
FCF (Free Cash Flow)	-745	-1,066	1,091	963
EBITDA Margin (%)	3.8	5.7	8.6	7.6
Operating Profit Margin (%)	-0.4	1.3	2.1	2.3
Net Profit Margin (%)	25.1	2.5	6.2	7.2

Statement of Financial Condition (Summarized)

(Wbn)	12/17	12/18	12/19F	12/20F
Current Assets	13,362	15,477	18,212	19,574
Cash and Cash Equivalents	1,042	718	1,818	2,944
AR & Other Receivables	979	926	5,592	5,743
Inventories	248	424	2,558	2,627
Other Current Assets	11,093	13,409	8,244	8,260
Non-Current Assets	8,535	12,141	13,135	12,868
Investments in Associates	3,804	7,135	7,423	7,624
Property, Plant and Equipment	1,472	2,589	2,336	1,912
Intangible Assets	1,665	921	929	863
Total Assets	21,897	27,618	31,347	32,442
Current Liabilities	7,508	16,340	17,320	17,693
AP & Other Payables	2,207	1,172	803	825
Short-Term Financial Liabilities	4,692	4,062	3,963	3,975
Other Current Liabilities	609	11,106	12,554	12,893
Non-Current Liabilities	6,900	2,845	4,766	4,817
Long-Term Financial Liabilities	5,456	1,332	2,855	2,855
Other Non-Current Liabilities	1,444	1,513	1,911	1,962
Total Liabilities	14,407	19,185	22,086	22,511
Controlling Interests	6,115	7,113	7,677	8,284
Capital Stock	15	21	21	21
Capital Surplus	7,057	4,249	4,246	4,246
Retained Earnings	476	6,029	5,867	6,474
Non-Controlling Interests	1,375	1,320	1,584	1,647
Stockholders' Equity	7,490	8,433	9,261	9,931

Cash Flows (Summarized)

(Wbn)	12/17	12/18	12/19F	12/20F
Cash Flows from Op Activities	-684	-827	1,211	963
Net Profit	495	111	630	727
Non-Cash Income and Expense	-463	164	-202	-645
Depreciation	54	220	513	424
Amortization	24	93	69	65
Others	-541	-149	-784	-1,134
Chg. in Working Capital	-836	-1,637	2	192
Chg. in AR & Other Receivables	-106	125	-3,615	-117
Chg. in Inventories	25	-88	-2,162	-69
Chg. in AP & Other Payables	-26	-169	815	22
Income Tax Paid	-18	-102	-151	-87
Cash Flows from Inv Activities	1,306	-2,248	-92	-20
Chg. in PP&E	-58	-229	-117	0
Chg. in Intangible Assets	-14	-30	-29	0
Chg. in Financial Assets	-10,486	10,583	57	-37
Others	11,864	-12,572	-3	17
Cash Flows from Fin Activities	-327	3,414	-205	-150
Chg. in Financial Liabilities	9,517	-4,753	1,423	13
Chg. in Equity	7,032	-2,802	-2	0
Dividends Paid	0	-7	-92	-57
Others	-16,876	10,976	-1,534	-106
Increase (Decrease) in Cash	288	-323	440	1,127
Beginning Balance	754	1,042	1,378	1,818
Ending Balance	1,042	718	1,818	2,944

Forecasts/Valuations (Summarized)

	12/17	12/18	12/19F	12/20F
P/E (x)	6.1	30.2	7.3	6.0
P/CF (x)	88.7	20.3	9.4	49.0
P/B (x)	0.7	0.6	0.4	0.4
EV/EBITDA (x)	64.4	28.3	13.0	12.8
EPS (W)	10,602	1,746	5,207	6,265
CFPS (W)	734	2,591	4,040	772
BPS (W)	99,961	85,554	90,884	96,615
DPS (W)	0	800	800	800
Payout ratio (%)	0.0	51.2	9.0	7.8
Dividend Yield (%)	0.0	1.5	2.1	2.1
Revenue Growth (%)	-16.9	289.0	23.2	2.8
EBITDA Growth (%)	-68.3	478.9	87.3	-9.1
Operating Profit Growth (%)	-	-	91.8	11.7
EPS Growth (%)	439.5	-83.5	198.2	20.3
Accounts Receivable Turnover (x)	4.2	11.2	3.5	2.1
Inventory Turnover (x)	7.5	21.7	6.0	3.6
Accounts Payable Turnover (x)	2.9	6.6	7.9	8.0
ROA (%)	3.8	0.4	2.1	2.3
ROE (%)	11.0	2.8	7.5	8.3
ROIC (%)	-0.3	3.3	3.2	3.4
Liability to Equity Ratio (%)	192.4	227.5	238.5	226.7
Current Ratio (%)	178.0	94.7	105.2	110.6
Net Debt to Equity Ratio (%)	-22.1	49.1	47.8	33.2
Interest Coverage Ratio (x)	-0.5	1.3	0.9	1.1

Source: Company data, Mirae Asset Daewoo Research estimates

Lotte Data Communication (286940 KS)

Group IT investments to drive earnings growth

Investment points: Only IT services provider within Lotte Group

1) Group IT investments to drive earnings growth

Lotte Data Communication acts as Lotte Group's IT control tower and generates around 80% of its revenue from group affiliates. Lotte Group has announced plans to invest W50tr across its domestic and overseas businesses over the next five years. We believe this will lead to new business opportunities and meaningful earnings growth for Lotte Data Communication, which will likely take charge of the group's IT infrastructure projects, such as the establishment of smart factories and logistics systems.

2) Gradual margin improvement

Driven by increasing affiliate demand in high-tech sectors related to the group's digital transformation, such as IoT, cloud computing, big data, and mobility, we expect the company's revenue mix to shift toward such high-margin businesses. As a result, margins should grow more rapidly than revenue.

3) HIT merger effects to materialize in 2H19

On July 1st, Lotte Data Communication finalized its merger with subsidiary Hyundai Information Technology (HIT). In 2Q19, HIT turned to an operating profit, thanks to the normalization of its Yongin data center from late March (2Q19 utilization was 95%). Following the merger, we believe the company will capture various business opportunities from non-affiliates and overseas markets, especially in areas like data centers and SOC (railway, airports, and ports.), in 2H19. We also expect the merger to help improve the company's cost competitiveness through savings in administrative expenses.

4) Inorganic growth via M&As

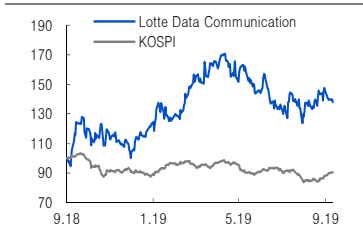
Backed by large cash holdings (W249.2bn as of end-1H19), the company is weighing M&As to expand overseas. We expect the company to secure additional growth overseas, while enjoying stable domestic growth from group affiliates.

Maintain Buy and TP of W63,000; Undervalued, given profit growth potential

We reaffirm our Buy rating and target price of W63,000 on Lotte Data Communication. At a 2019F P/E of 14x, the stock's valuation looks attractive relative to peers, such as Samsung SDS (018260 KS/Buy/TP: W290,000/CP: W200,500; 22x) and Hyundai Autoever (307950 KS/CP: W55,400; 19x).

For the full year, we forecast revenue of W901.8bn (+11.1% YoY), operating profit of W49.2bn (+26.1% YoY), and net profit attributable to controlling interests of W59.2bn (+125% YoY). We believe the company will easily exceed its full-year guidance (revenue growth of more than 10% and OP margin of more than 4.8%).

(Maintain)	Buy		
Target Price (12M, W)	63,000		
Share Price (09/17/19, W)	41,500		
Expected Return	52%		
OP (19F, Wbn)	49		
Consensus OP (19F, Wbn)	51		
EPS Growth (19F, %)	81.1		
Market EPS Growth (19F, %)	-28.1		
P/E (19F, x)	10.4		
Market P/E (19F, x)	13.1		
KOSPI	2,062.33		
Market Cap (Wbn)	639		
Shares Outstanding (mn)	15		
Free Float (%)	30.5		
Foreign Ownership (%)	1.6		
Beta (12M)	0.04		
52-Week Low	30,100		
52-Week High	51,300		
(%)	1M	6M	12M
Absolute	2.0	-8.8	23.5
Relative	-4.7	-3.8	37.9



FY (Dec.)	12/15	12/16	12/17	12/18	12/19F	12/20F
Revenue (Wbn)	-	-	149	812	902	1,011
OP (Wbn)	-	-	5	39	49	57
OP margin (%)	-	-	3.4	4.8	5.4	5.6
NP (Wbn)	-	-	2	26	59	46
EPS (W)	-	-	1,139	2,205	3,991	3,010
ROE (%)	-	-	1.0	9.6	15.8	11.1
P/E (x)	-	-	-	16.1	10.4	13.8
P/B (x)	-	-	-	1.4	1.6	1.5
Dividend yield (%)	-	-	-	1.8	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

Earnings and forecasts

Revenue to expand by more than 10% annually

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.

And the firm's profit should grow faster than revenue, given that there is increasing demand from group affiliates for high-tech areas such as IoT, big data and mobility (related to the fourth industrial revolution and digital transformation), which tend to generate higher margins.

Backed by large cash holdings (W249.2bn as of end-1H19), the company is weighing M&As to expand overseas. We expect the company to secure additional growth overseas, while enjoying stable domestic growth from group affiliates.

Table 23. Quarterly and annual earnings breakdown

(Wbn, %)

	1Q18	2Q18	3Q18	4Q18	1Q19	2Q19	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	49.2	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	5.5	5.7
SM	3.8	3.8	4.4	6.5	5.2	6.1	5.5	7.2	11.5	12.7	14.1	18.5	24.0	25.0
OP margin	9.2	8.9	9.7	13.3	11.3	12.7	10.8	12.0	9.1	9.2	9.4	10.4	11.7	11.2
SI	1.9	5.3	2.9	10.3	0.4	7.6	5.3	11.8	17.4	6.2	20.1	20.5	25.1	32.2
OP margin	1.4	3.4	2.0	5.5	0.3	4.5	3.2	5.3	2.9	1.0	3.0	3.2	3.6	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
Revenue					1.4	8.1	12.8	19.8	2.4	4.6	6.6	-1.0	11.1	12.1
SM					12.2	12.4	13.0	22.7	4.7	8.7	9.4	17.7	15.3	9.2
SI					-1.7	6.9	12.7	19.0	1.9	3.8	6.0	-5.2	9.9	13.0
Operating profit					-1.7	50.9	46.7	15.8	2.1	-34.7	80.7	14.0	26.1	16.3
SM					36.8	60.5	25.4	10.8	8.1	10.3	11.2	30.8	29.9	4.2
SI					-77.2	44.0	78.4	14.7	-1.5	-64.4	223.4	2.1	22.7	27.9
Pretax profit					-13.3	79.7	47.0	70.4	1.0	-36.3	82.8	25.4	51.7	16.5
Net profit					-26.0	396.4	85.3	83.5	1.0	-29.6	73.1	13.4	146.6	-19.6
Net profit (controlling)					-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: Lotte Data Communication, Mirae Asset Daewoo Research

Investment points

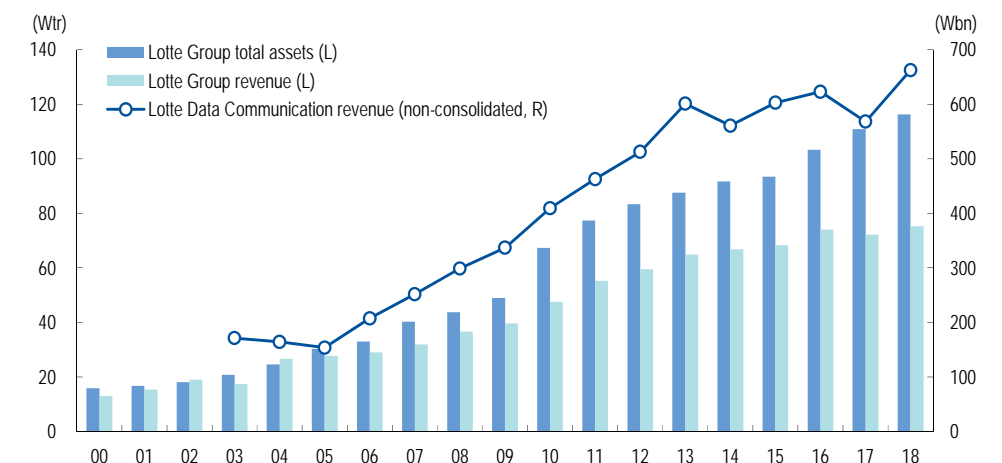
1. Biggest beneficiary of Lotte Group's IT investments

1) The only IT services firm under Lotte Group's umbrella

Lotte Data Communication acts as Lotte Group's IT control tower and generates around 80% of its revenue from group affiliates. Domestic IT service providers affiliated with conglomerates, including Lotte Data Communication, can maintain steady revenue growth based on captive demand from affiliates. Most of them are the exclusive providers of IT services to affiliates, as they are better positioned (vs. external competitors) to ensure group-level security (in processing sensitive data such as business strategy and customer information) and swiftly and efficiently respond to unexpected events.

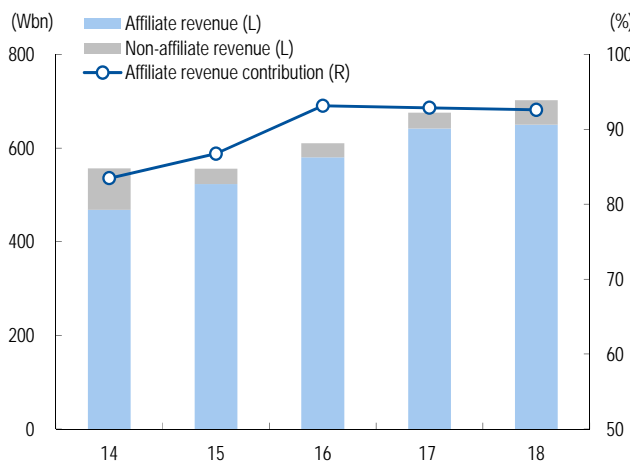
Going forward, we expect Lotte Data Communication to continue to derive a significant share of its revenue from group affiliates. The company's top five affiliate customers are: Lotte Shopping, Lotte Card, Lotte E&C, Hotel Lotte, and Woori Home Shopping, which collectively account for 46.2% of its total revenue.

Figure 43. Lotte Group's assets and revenue; Lotte Data Communication's revenue



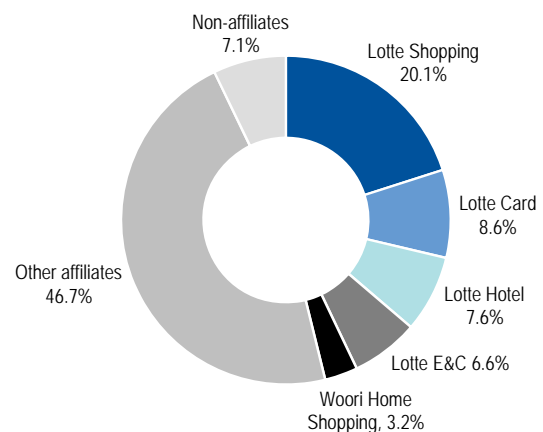
Source: DART, Mirae Asset Daewoo Research

Figure 44. Affiliate revenue and contribution



Source: Lotte Data Communication, Mirae Asset Daewoo Research

Figure 45. Revenue breakdown by customer (2017)



Source: Lotte Data Communication, Mirae Asset Daewoo Research

2) Lotte Group's five-year investment plan

In October 2018, Lotte Group announced a plan to invest a total of W50tr across all of its domestic and overseas businesses through 2023. With the goal of achieving group-wide digital transformation, Lotte Group is seeking to better serve customers and find new growth opportunities in the rapidly changing business environment. Specifically, the group plans to strengthen its competitiveness and identify future growth engines in retail and chemicals, which it considers the two pillars of growth.

We believe the investments will benefit Lotte Data Communication, as the company should directly engage in building the group's IT infrastructure including smart factories, smart logistics, etc.

① Retail

On the retail front, the group's first priority is building the largest e-commerce platform in Korea. In May 2018, it unveiled a plan to invest W3tr in its online retail operations over the next five years, including: 1) W500bn to integrate the group's online shopping malls and develop an online payment system; 2) W1tr to build an integrated logistics system; and 3) W1.5tr for marketing. Lotte Group has already established an e-commerce division to consolidate its eight online shopping malls (e.g., Lotte Department Store, Lotte Mart, Lotte Home Shopping, etc.) and the online sub-units of its offline businesses. Going forward, the group aims to increase its online revenue from W7tr (18% revenue share) in 2018 to W20tr (30%) in 2022.

② Food

In the food business, Lotte Group will focus on developing market-leading products to meet ever-changing customer needs. To that end, the group will increase investments in AI to proactively analyze emerging food trends and develop new products.

③ Chemicals

Lotte Group will aim to achieve economies of scale and enhance cost competitiveness through steady investments in domestic production bases (Yeosu, Ulsan, and Daesan). It also plans to make large-scale capex investments overseas.

④ Tourism and other services

Lotte Group will strive to increase its brand value through steady business expansion at home and abroad. Specifically, the group will strengthen its Indonesian and Vietnamese operations, tap into new markets, and seek M&A opportunities.

Table 24. Lotte Group's five-year investment plan (2019-23)

(Wbn)

	Details	%	Amount
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	<ul style="list-style-type: none"> • Steady domestic and overseas expansion 	25%	12.5
Total		100%	50.0

Source: Lotte Group, Mirae Asset Daewoo Research

3) Group-wide digital transformation

Lotte Group plans to build the One Lotte Smart Ecosystem encompassing smart factories, smart logistics, and smart retail. We believe these efforts will bolster competitiveness, increasing the company's prospects for winning non-affiliate deals and driving sustainable growth.

① Smart factories

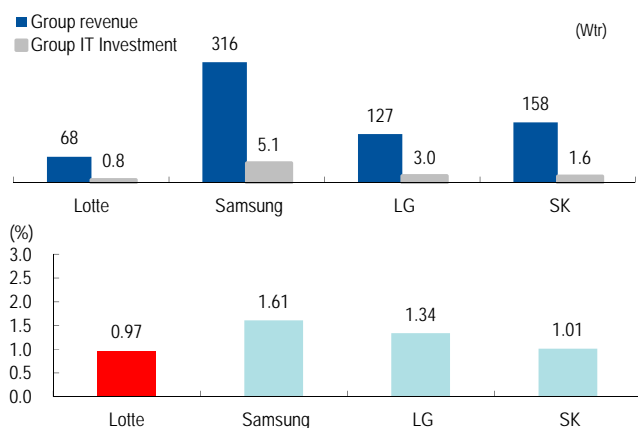
A smart factory combines all elements of production (from design/development to logistics) with information and communication technologies to make the manufacturing process more intelligent and improve product quality. An increasing number of manufacturers are harnessing the IoT to digitalize their factories.

Lotte Group has likewise embarked on an initiative to introduce smart manufacturing in its subsidiaries, including Lotte Chilsung and Lotte Confectionery in F&B, Lotte Chemical and Lotte Fine Chemical in chemicals, and Lotte Aluminium in manufacturing. Through 2022, over W140bn will be invested to convert 88 factories (48 domestic and 40 overseas) into smart factories (W36bn in 2019-20; W104bn in 2021-22).

② Smart logistics

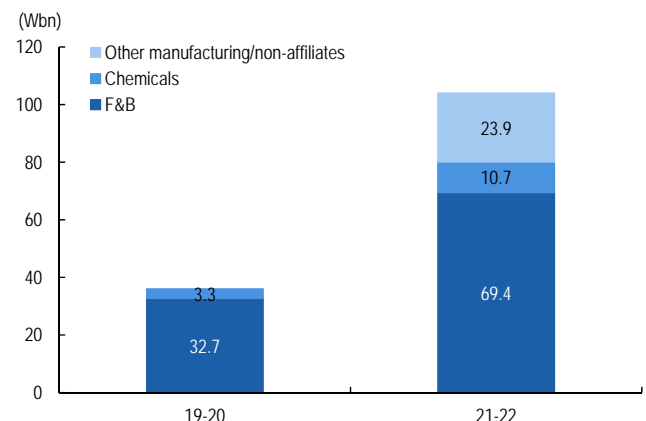
Smart logistics is an integrated, IT-based system that enables real-time logistics control, management, and operation. Lotte Group has consolidated its logistics operations (Lotte Global Logistics and Lotte Logistics) and plans to build a smart logistics service center that will encompass system development, maintenance, and operations.

Figure 46. IT investment-to-revenue ratio by conglomerate



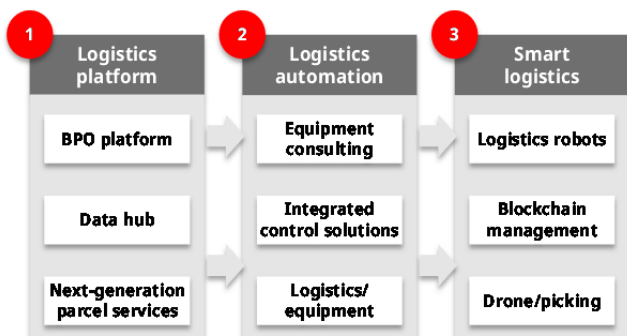
Source: Lotte Data Communication, Mirae Asset Daewoo Research

Figure 47. Lotte Data Communication's smart factory business plan



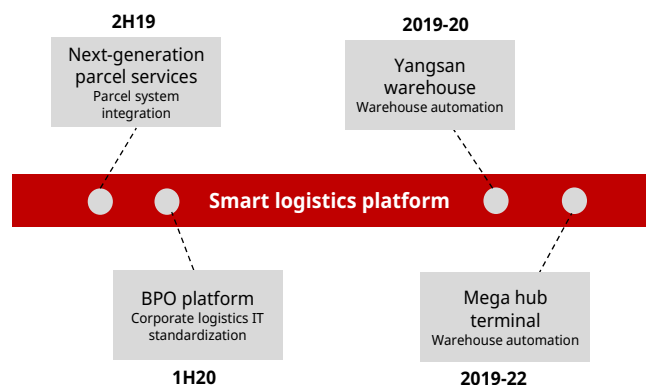
Source: Lotte Data Communication, Mirae Asset Daewoo Research

Figure 48. Lotte Data Communication's smart logistics business plan



Source: Lotte Data Communication, Mirae Asset Daewoo Research

Figure 49. Lotte Group's smart logistics project



Source: Lotte Data Communication, Mirae Asset Daewoo Research

③ Smart retail

Smart retail describes a set of smart technologies that are designed to give the consumer a faster, safer, smarter experience when shopping. As part of its efforts to build a smart retail platform, Lotte Group is integrating and digitalizing its online and offline retail channels. Looking ahead, the group should be able to ensure sustainable growth through omni-channel retail and conversion to smart stores/convenience stores.

In the small-sized store segment, Lotte has already opened a 13th smart convenience store and one Food Dream store (a premium convenience store brand). Moreover, it is incorporating IoT into its business model to operate cashier-less stores and improve delivery services. In the large-sized store segment, the group plans to offer personalized product recommendations (through integrated online/offline data analysis) and digital transformation-based store management services.

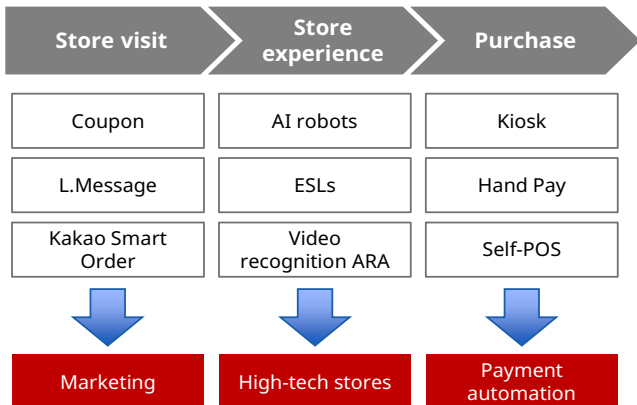
In addition, the group will use voice commerce technology, which allows customers to get recommendations and buy items using voice commands. Voice commerce is widely viewed as the next big thing in e-commerce.

④ Other businesses

Lotte Data Communication is also likely to secure a variety of smart city-related business opportunities, based on its track record in high-rise smart buildings and next-generation cooperative intelligent transport systems (C-ITS). In addition, the company should be able to generate additional revenue via AI- and big data-based business opportunities and recurring income business models (such as cloud service brokerage).

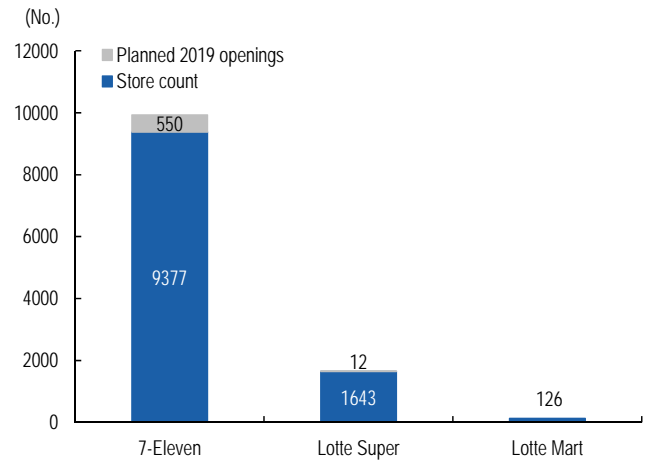
Furthermore, Lotte Data Communication started construction of a key customer's fourth data center in April 2019. And based on its experience providing IT infrastructure/service platforms to affiliate customers, the company is likely to win non-affiliate projects, particularly in Indonesia and Vietnam.

Figure 50. Lotte Data Communication's smart retail platform



Source: Lotte Data Communication, Mirae Asset Daewoo Research

Figure 51. Lotte Group's retail store count (as of Jan. 2019)



Note: Excluding department stores and discount outlets

Source: Mirae Asset Daewoo Research

Figure 52. Lotte smart buildings

Smart buildings

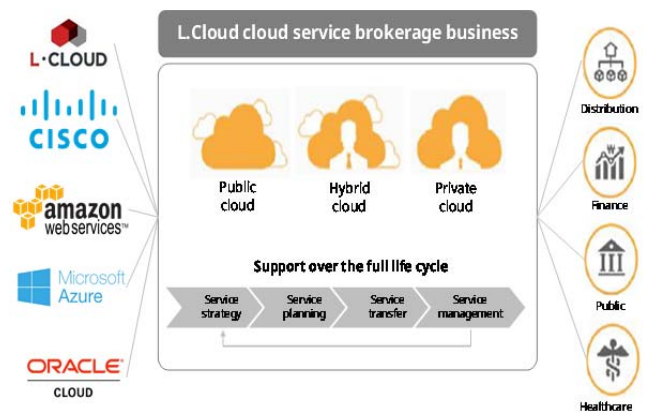


In the pipeline



Source: Lotte Data Communication, Mirae Asset Daewoo Research

Figure 53. Lotte Data Communication's cloud service brokerage business



Source: Lotte Data Communication, Mirae Asset Daewoo Research

2. Margins to improve full swing

Going forward, we expect Lotte Data Communication to deliver solid revenue growth, aided by the Lotte Group's increasing IT investments. Meanwhile, margins will likely improve more rapidly than revenue, as demand for low-margin IT projects is decreasing, while demand for high-margin platform projects based on IoT, cloud computing, and AI is expanding.

In addition, the company will likely enjoy additional margin improvement thanks to a hike in software engineer service fees. Lotte Data Communication's main businesses are SI (for system stabilization/improvement/efficiency) and the subsequent management of deployed systems (SM; maintenance, upgrades, etc.). As such, if SI projects increase, this would expand SM revenue opportunities. Therefore, the major determinant of the company's overall profitability is margin improvement in the SM business, which generally hinges on software engineer service fees paid by customers.

Currently, IT service fees are based on the software engineer service fee table released annually by the Korea Software Industry Association (KOSA). KOSA service fee rates have been raised by 3-5% annually. While Samsung SDS and SK C&C currently receive the highest rates in the table, Lotte Data Communication charges only around 80% of the highest rates, suggesting ample room for fee increases. As such, we believe that gradual hikes will lead to margin improvement.

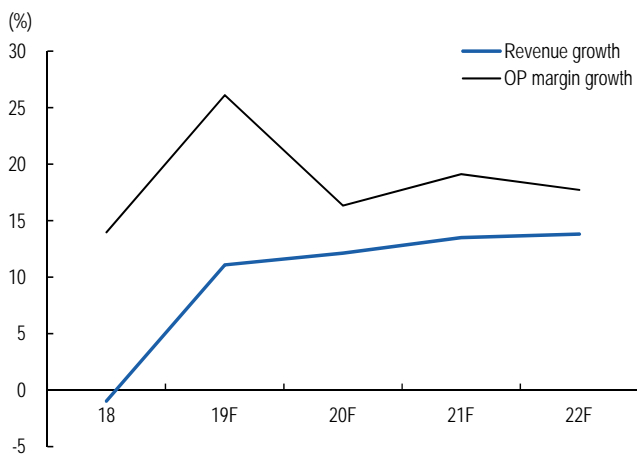
Table 25. Software engineer fee rate table

(W'000/day)

Classification			2013	2014	2015	2016	2017	2013	2014	2015	2016	2017
			Rate	Rate	Rate	Rate	Rate	Growth	Growth	Growth	Growth	Growth
Technician	Early career		115	117	119	119	115	7.0%	1.8%	1.7%	0.4%	-3.6%
	Mid-career		126	141	141	147	158	12.4%	11.3%	0.5%	4.5%	7.5%
	Advanced		155	172	177	187	191	7.9%	11.6%	2.9%	5.5%	2.2%
Engineer	Early career	(Staff)	182	189	191	191	191	5.4%	3.8%	0.9%	0.0%	0.3%
	Mid-career	(Assistant manager)	219	221	221	227	240	5.7%	0.9%	0.0%	2.3%	5.7%
	Advanced	(Manager)	267	272	276	284	305	4.6%	2.1%	1.5%	3.0%	7.4%
	Expert	(Director)	357	376	374	382	391	2.3%	5.3%	-0.7%	2.1%	2.5%
Licensed engineers			398	409	412	437	453	1.7%	2.7%	0.6%	6.2%	3.5%

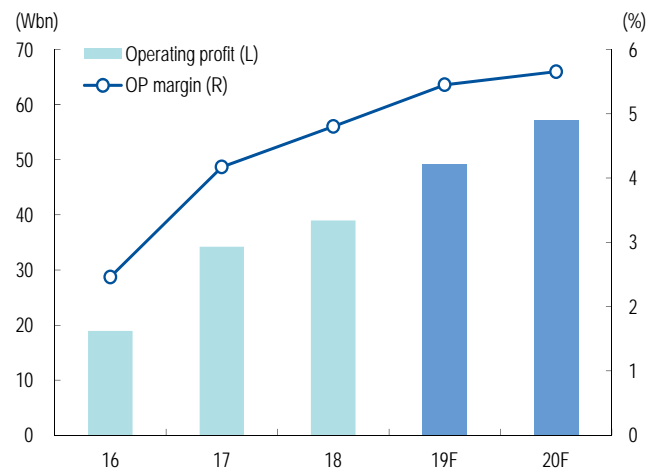
Source: KOSA, Mirae Asset Daewoo Research

Figure 54. Margins grew faster than revenue in 2018



Source: Lotte Data Communication, Mirae Asset Daewoo Research

Figure 55. OP and OP margin of Lotte Data Communication



Source: Lotte Data Communication, Mirae Asset Daewoo Research

3. Post-merger effects to materialize in 2H

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. As merger synergies begin to take hold in 2H, we expect the company to win more data center and SOC projects (railway, airports and ports, etc.) at home and abroad. Post-merger cost savings should also lead to efficient resource allocation and enhanced cost competitiveness, which will start being reflected in earnings from 2H19.

Table 26. 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 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 overseas subsidiaries' (Vietnam, Indonesia, and China) 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: Lotte Data Communication, Mirae Asset Daewoo Research

Table 27. Expected changes: Pre-merger vs. post-merger

(No. of shares)

Shareholder	Pre-merger				Post-merger		Note
	Lotte Data Communication (acquirer)	HIT (acquiree)	Lotte Data Communication				
	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 Communication
HIT	0	0.0	15,385	0.0	0	0.0	
Treasury stock					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 56. Current integrated data center overview



Source: Lotte Data Communication, Mirae Asset Daewoo Research

Figure 57. Construction of fourth data center (global cloud center) underway



Source: Lotte Data Communication, Mirae Asset Daewoo Research

4. Inorganic growth

In its IPO in July 2018, Lotte Data Communication raised W127.7bn, issuing 4,286,000 new shares at a price of W29,800. As of 1H19, the company holds W249.2bn in cash and cash equivalents.

The company plans to use its ample cash to advance technologies for existing businesses, develop IT platforms for IoT, cloud computing, big data, mobile communications, and blockchain services, and further expand into Indonesia and Vietnam. Of note, we believe that the company will likely seek M&A opportunities to expand overseas.

Lotte Data Communication has already established business footholds in Vietnam, Indonesia, and Russia to meet IT investment demand from overseas group affiliates and look for global business opportunities. Given that overseas revenue made just a single-digit contribution to total revenue in 2018, we see room for further growth going forward. If the company clinches some global M&A deals, it will be able to secure additional drivers.

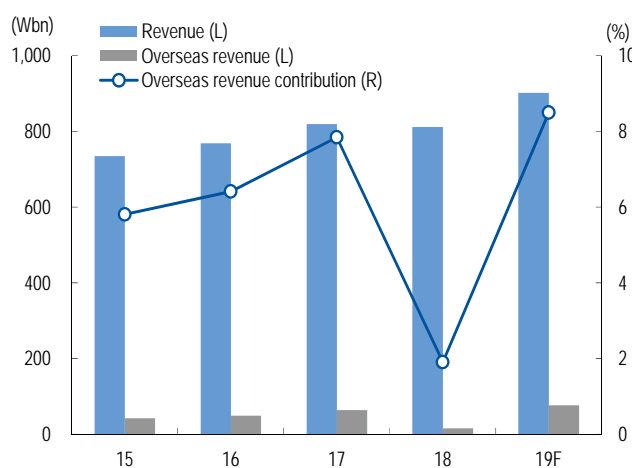
Table 28. Lotte Data Communication's plans to use capital raised via IPO

(Wbn)

Goals		Details	2018	2019	2020	Total
I	Development of integrated logistics/SCM solutions	Logistics IT standardization; development of integrated logistics platform led by Lotte Global Logistics	6.0	4.0	1.0	11.0
	Development of POS-based retail payment solutions	360 barcode scanners (unmanned POS); finger vein payments	8.0	4.0	2.0	14.0
	Development of integrated security control solutions	AI-based analysis of fraud detection patterns; improvement in IoT sensors	2.0	2.0	1.0	5.0
	Total (I)		16.0	10.0	4.0	30.0
II	Development of integrated AI/big data platforms for marketing, R&D, chatbots, call centers, etc.	Establishment of AI-based call centers and integrated AI/big data platforms	5.0	10.0	8.0	23.0
	Development of integrated IoT/blockchain platforms for tracking agricultural/ livestock/ fishery products, contract verification, etc.	Platforms for tracking agricultural/livestock/fisheries products, electronic certification, and blockchain services	8.0	7.0	7.0	22.0
	Cloud equipment purchases and infrastructure investment	Cloud server and infrastructure capacity expansion; investment in network expansion	1.0	5.0	9.0	15.0
	Network expansion, energy-saving equipment installation	System development for entry into the mobile coupon market	8.0	2.0	-	10.0
	Total (II)		22.0	24.0	24.0	70.0
III	Retail solution and electronic payment system businesses in Indonesia	Entry into the total store operation solution market	1.0	6.0	3.0	10.0
	Retail solution, smart city, and stock trading solution businesses in Vietnam	Electronic payment and stock trading solutions; investment in smart city projects	4.0	11.0	2.7	17.7
	Total (III)		5.0	17.0	5.7	27.7
Total			43.0	51.0	33.7	127.7

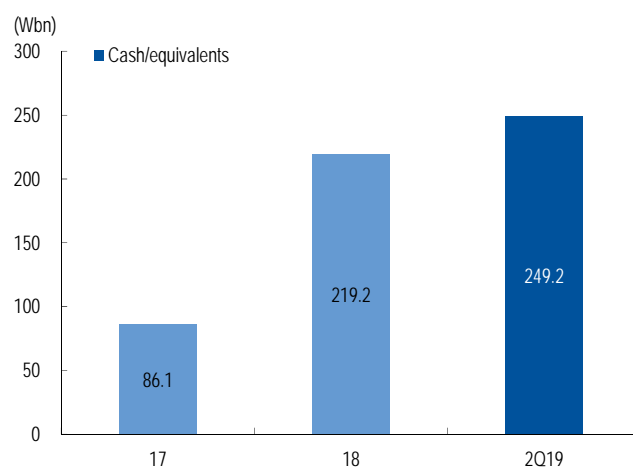
Source: Company data, Mirae Asset Daewoo Research

Figure 58. Overseas revenue contribution



Source: DART, Mirae Asset Daewoo Research

Figure 59. Cash and cash equivalents



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	902	1,011
Cost of Sales	137	741	816	913
Gross Profit	12	71	86	98
SG&A Expenses	6	32	37	41
Operating Profit (Adj)	5	39	49	57
Operating Profit	5	39	49	57
Non-Operating Profit	-2	-4	3	4
Net Financial Income	0	-1	1	1
Net Gain from Inv in Associates	0	0	0	0
Pretax Profit	3	35	52	61
Income Tax	0	11	-5	15
Profit from Continuing Operations	2	23	58	46
Profit from Discontinued Operations	0	0	0	0
Net Profit	2	23	58	46
Controlling Interests	2	26	59	46
Non-Controlling Interests	1	-3	-2	0
Total Comprehensive Profit	3	23	58	46
Controlling Interests	3	26	81	64
Non-Controlling Interests	0	-3	-23	-18
EBITDA	10	71	83	84
FCF (Free Cash Flow)	-16	79	90	89
EBITDA Margin (%)	6.7	8.7	9.2	8.3
Operating Profit Margin (%)	3.4	4.8	5.4	5.6
Net Profit Margin (%)	1.3	3.2	6.5	4.5

Statement of Financial Condition (Summarized)

(Wbn)	12/17	12/18	12/19F	12/20F
Current Assets	280	404	532	648
Cash and Cash Equivalents	76	163	237	306
AR & Other Receivables	131	132	158	184
Inventories	17	12	15	17
Other Current Assets	56	97	122	141
Non-Current Assets	303	299	280	253
Investments in Associates	0	0	0	0
Property, Plant and Equipment	210	217	202	180
Intangible Assets	32	27	21	17
Total Assets	583	704	812	902
Current Liabilities	327	311	363	411
AP & Other Payables	162	193	231	269
Short-Term Financial Liabilities	123	61	63	63
Other Current Liabilities	42	57	69	79
Non-Current Liabilities	38	27	34	39
Long-Term Financial Liabilities	3	1	3	3
Other Non-Current Liabilities	35	26	31	36
Total Liabilities	365	337	396	450
Controlling Interests	197	348	399	436
Capital Stock	50	71	71	71
Capital Surplus	143	248	248	248
Retained Earnings	3	29	80	116
Non-Controlling Interests	21	18	16	16
Stockholders' Equity	218	366	415	452

Cash Flows (Summarized)

(Wbn)	12/17	12/18	12/19F	12/20F
Cash Flows from Op Activities	-10	107	103	89
Net Profit	2	23	58	46
Non-Cash Income and Expense	10	64	32	40
Depreciation	4	26	27	22
Amortization	1	6	7	5
Others	5	32	-2	13
Chg. in Working Capital	-22	25	6	18
Chg. in AR & Other Receivables	-23	-2	-27	-25
Chg. in Inventories	4	4	-2	-2
Chg. in AP & Other Payables	-5	31	1	20
Income Tax Paid	0	-5	7	-15
Cash Flows from Inv Activities	1	-77	-27	-8
Chg. in PP&E	-6	-28	-13	0
Chg. in Intangible Assets	-3	-4	-1	0
Chg. in Financial Assets	-18	-40	-11	-11
Others	28	-5	-2	3
Cash Flows from Fin Activities	-6	57	-3	-12
Chg. in Financial Liabilities	126	-64	4	0
Chg. in Equity	193	126	0	0
Dividends Paid	0	0	0	-10
Others	-325	-5	-7	-2
Increase (Decrease) in Cash	-15	87	74	70
Beginning Balance	91	76	163	237
Ending Balance	76	163	237	306

Forecasts/Valuations (Summarized)

	12/17	12/18	12/19F	12/20F
P/E (x)	-	16.1	10.4	13.8
P/CF (x)	-	4.8	6.9	7.4
P/B (x)	-	1.4	1.6	1.5
EV/EBITDA (x)	-	5.1	5.0	3.9
EPS (W)	1,139	2,205	3,991	3,010
CFPS (W)	7,380	7,353	6,044	5,625
BPS (W)	19,679	24,419	25,926	28,287
DPS (W)	0	650	650	650
Payout ratio (%)	0.0	39.7	17.4	21.6
Dividend Yield (%)	-	1.8	1.6	1.6
Revenue Growth (%)	-	445.0	11.1	12.1
EBITDA Growth (%)	-	610.0	16.9	1.2
Operating Profit Growth (%)	-	680.0	25.6	16.3
EPS Growth (%)	-	93.6	81.0	-24.6
Accounts Receivable Turnover (x)	1.1	6.3	6.4	6.1
Inventory Turnover (x)	8.9	56.0	66.5	63.3
Accounts Payable Turnover (x)	1.5	7.6	7.2	6.9
ROA (%)	0.4	3.6	7.6	5.4
ROE (%)	1.0	9.6	15.8	11.1
ROIC (%)	1.9	12.5	34.7	34.2
Liability to Equity Ratio (%)	167.8	92.1	95.4	99.7
Current Ratio (%)	85.5	130.1	146.6	157.6
Net Debt to Equity Ratio (%)	18.5	-42.9	-58.6	-71.7
Interest Coverage Ratio (x)	27.4	12.1	22.8	26.5

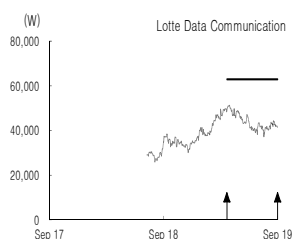
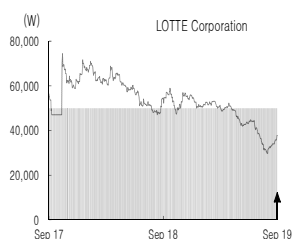
Source: Company data, Mirae Asset Daewoo Research estimates

APPENDIX 1

Important Disclosures & Disclaimers

2-Year Rating and Target Price History

Company (Code)	Date	Rating	Target Price	Company (Code)	Date	Rating	Target Price
Lotte Corporation (004990)	09/18/2019	Buy	52,000	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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