AMORE PACIFIC is going to PACIFIC OCEAN

-Amore Pacific (090430 KS)

Leading Research Center

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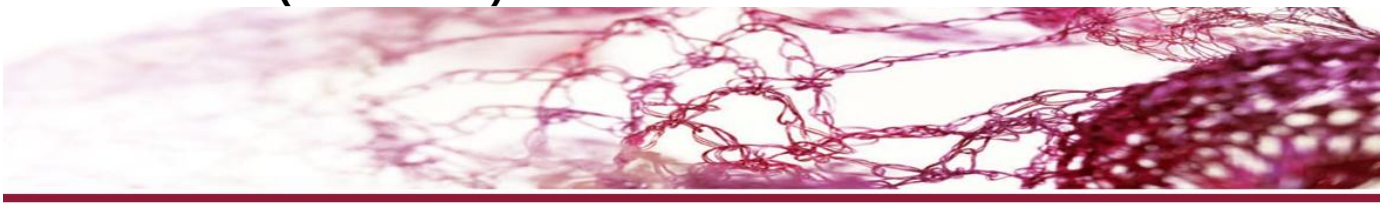
Amore Pacific (090430 KS)



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SNAPSHOT: 'Under Construction'… waiting for 2014

Amore Pacific is the top domestic cosmetic manufacturer commanding the market share of 32.7%.

Amore Pacific is growing with luxury cosmetics

The proportion of luxury cosmetics is 62.7% in 2012, of which Sulwhasoo (an oriental medicine cosmetic line) is the largest component.

The luxury cosmetics market growth slowdown due to economic recession

Growth of the luxury cosmetics market has slowed down due to economic recession from 2008 and the increase in demand for low price cosmetics in domestic market.
Growth of the luxury cosmetics market: 12.3% in 2009 →9.7% in 2011
Growth of the AMORE PACIFIC luxury cosmetics: 19.9% in 2009 →9.9% in 2011

Growth of Amore Pacific slows down given growth of low-end cosmetics

Amore Pacific sells luxury cosmetics via department stores as well as door-to-door sales and mass cosmetics (mid-price) via discount stores, specialty stores, and online.
Korean cosmetic market grows with low-price cosmetics. Low-price cosmetics of Amore Pacific are produced by Amore G which is the holding company of Amore Pacific. Given the growth oriented with low-price cosmetics, earnings growth of AMORE PACIFIC slows down and is expected to CAGR 11~13% in foreseeable future.

Luxury cosmetics will grow along with economic indices improvement

Decrease in luxury cosmetics sales, which have high profitability, leads larger decrease in operating profit than decline in revenue. Poor door-to-door sales (4.7% in 2011) lead to a drop of the company's total OPM decline to 14.6% in 2011 from 15.8% in 2010. The company boosting door-to-door sales by hiring 2,000 counselors for door-to-door sales in 2012. Sales in door-to-door has grown along with counselors. The revenue of luxury cosmetics is estimated to grow 8.2% yoy in 2012.

What is the growth engine of Amore Pacific? Overseas sales! China!!

Overseas sales is expected to account for 20% of total sales in 2014 (vs 12.8% in 2011) with CAGR of 28.5%. Especially, Sales in China, which accounts for 58.3% of total overseas sales, has grown 41.6% annually for last 4 years. In China, Amore Pacific has a high reputation as a premium brand and expands its market share through product mix from luxury to low-end cosmetics. Revenue in the region will be likely to grow 34.8% annually by 2014. Moreover, the company plans to expand capacity of W1.6tr by 2014 to improve price competitiveness and market access.

Coming 2014… Amore Pacific is reborn over

1. Overseas business: fast growth (CGAR 2011~2014: 28.5%) + profitability improvement (overseas sales OPM : 0.8% in 2011 vs. 23.3% in 2014F)
2. Production capacity will be upgraded by 2014
3. Top of the Top Premium
4. The next concept which leads Korean cosmetic market after 'Herbal cosmetics' is 'Cosmeceutical.' Amore Pacific releases 'Aestura' , which is a cosmeceutical product and is sold by Pacific Pharma

Target price of W1,430,000

*No.1 Korean cosmetic company + abundant cash + entry into Asian market with high level R&D based products
*We apply the cosmetics industry 2013F PER of 20X adding the premium of 15% in the overseas business growth.

Exhibit 1. Valuation

FY	Sales	% chg	OP	OPM	NP	EPS	EPS	P/E	EV/EBITDA	ROE	P/B
	(Wbn)	yoy	(Wbn)	(%)	(Wbn)	(W)	Growth(%)	(x)	(x)	(%)	(x)
2010	2,252.2	16.1	355.9	15.8	284.5	48,664	25.9	23.4	15.1	20.0	5.1
2011	2,554.7	13.4	372.9	14.6	327.3	55,942	15.0	18.8	13.6	17.8	3.4
2012E	2,882.6	12.8	398.0	13.8	295.9	49,224	(12.0)	22.7	13.0	13.1	3.2
2013E	3,218.6	11.7	463.0	14.4	357.0	59,648	21.2	18.7	10.6	14.0	2.9
2014E	3,623.8	12.6	568.7	15.7	437.0	73,264	22.8	15.2	8.6	15.1	2.5

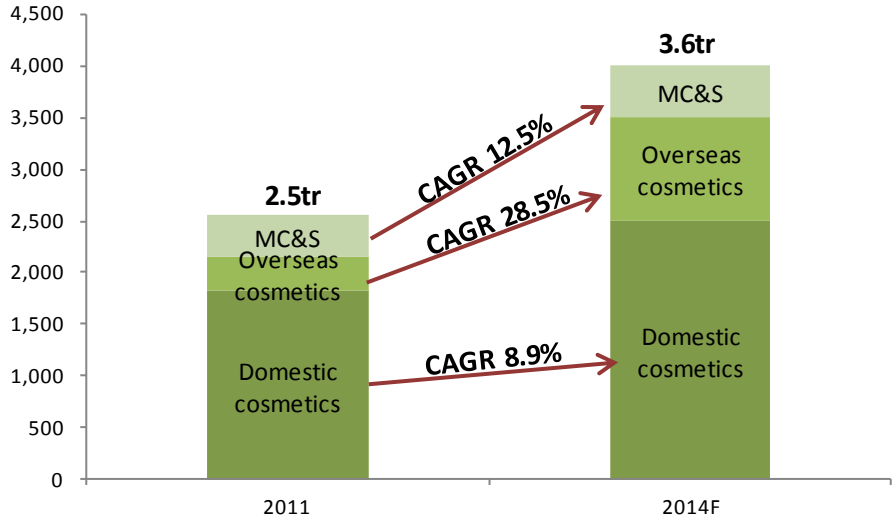
Source: Company data, Leading Research Center

1. Growth engine = Overseas business

:CAGR 28% in overseas markets vs. CAGR 9% in Korea

Annual growth in overseas cosmetics business of Amore Pacific is expected to be triple that of domestic cosmetics. Overseas business has grown 17% annually for last 4 years driven by fast growing Chinese cosmetics market (41.6% annual rate). As a result, the proportion of overseas business will increase to 19.1% in 2014F from 12.8% in 2011.

Exhibit 1. Revenue breakdown and annual growth by division (2011 vs. 2014F)



Source: Company data(2011), Leading Research Center

Amore Pacific entered diverse overseas markets such as China, France, U.S.A, Malaysia, and Singapore. Revenue in China accounts for 58.3% of total overseas revenue. Revenue in Asia including China is rapidly increasing driven by increasing the number of stores and brand awareness.

Exhibit 2. Overseas revenue proportion

(Wbn)	2010A	2011A	2012F	2013F	2014F	CAGR (2011~2014F)
Total	**2,272.2**	**2,554.6**	**2,882.6**	**3,218.6**	**3,623.8**	**12.4%**
Overseas sales	**266.6**	**327.2**	**428.6**	**540.4**	**693.7**	**28.5%**
Proportion	***11.7%***	***12.8%***	***14.9%***	***16.8%***	***19.1%***	
China	53.4%	58.3%	61.2%	64.2%	67.4%	34.8%
France	36.6%	30.7%	25.8%	22.7%	19.7%	10.8%
U.S.A	4.5%	4.8%	3.8%	3.0%	2.5%	3.0%
Asia	14.8%	14.4%	13.9%	13.8%	13.4%	25.2%

Source: Company data, Leading Research Center

2. How could China maintain high growth

Exhibit 3. Amore Pacific China revenue

	2010	2011	2012F	2013F	2014F
Revenue in China	**1,424**	**1,908**	**2,622**	**3,468**	**4,673**
Growth	22.7%	34.0%	37.4%	32.3%	34.7%
% of overseas sales	53.4%	58.3%	61.2%	64.2%	67.4%
% of total sales	6.3%	7.5%	9.1%	10.8%	12.9%
EVENT expected		Launched 'Innisfree'			Local factory construction completion

Source: Company data, Leading Research Center

China Cosmetics market of W30tr has grown 11.7% per annum from 2008, which is in top 3 after US and Japan in global market. The growth of GDP in China was 9.1%.

Exhibit 4. Chinese cosmetics company earnings

Company	Sales ($bn)					Sales growth (%)					OPM (%)				
	09	10	11	12	13	09	10	11	12	13	09	10	11	12	13
HENGAN INTLNATIONAL	10.8	13.4	17.1	19.9	24.6	35.4	24.0	26.9	17.0	23.1	23.6	21.0	18.3	22.0	21.8
SHANGHAI JAHWA	2.7	3.1	3.5	4.4	5.3	8.3	14.8	15.3	22.9	21.2	11.6	7.8	9.5	14.0	14.1

Source: Bloomberg, Leading Research Center

3. Why is Chinese into Amore? (1)

- **MADE IN KOREA PREMIUM**

Amore Pacific is in top 10 market share in skincare and makeup cosmetics. According to Euromonitor in 2011, Chinese skincare and makeup cosmetics markets size is W15tr (total market size of W30tr). In terms of retail sales, the market share of Amore Pacific is 2.1% in skincare cosmetics and 1.6% in makeup cosmetics.

Exhibit 5. M/S in China by company (2011)

Company	Skincare MS (%)
L'Oréal Groupe	16.1
Shiseido Co Ltd	10.1
Procter & Gamble Co, The	10.1
Mary Kay Inc	6.7
Amway Corp	5.7
Jala (Group) Co Ltd	3.5
Estée Lauder Cos Inc	3.2
Beiersdorf AG	3.0
Jiangsu Longliqi Group Co Ltd	2.6
Shanghai Jahwa United Co Ltd	2.4
Amore Pacific Corp	**2.1**
Johnson & Johnson Inc	2.1
Avon Products Inc	1.9
Shanghai Inoherb Cosmetics Co Ltd	1.9
Unilever Group	1.8
Kosé Corp	1.5
Fancl Corp	1.3
DHC Corp	1.2
LVMH Moët Hennessy Louis Vuitton SA	1.2
Guangzhou Meiji Cosmetics Co Ltd	1.1
Others	20.5
Total	**100.0**

Company	Makeup MS (%)
L'Oréal Groupe	34.1
Shiseido Co Ltd	5.9
Mary Kay Inc	2.8
LVMH Moët Hennessy Louis Vuitton SA	2.7
Amway Corp	2.2
Carlsan Group Hongkong Co Ltd	2.0
Revlon Inc	1.9
Amore Pacific Corp	**1.6**
Jala (Group) Co Ltd	1.5
Estée Lauder Cos Inc	1.2
Avon Products Inc	1.2
Procter & Gamble Co, The	1.2
Kao Corp	1.0
Chanel SA	0.9
DHC Corp	0.9
Nu Skin Enterprises Inc	0.8
Kosé Corp	0.6
Arche Group Co Ltd	0.5
Shanghai Jahwa United Co Ltd	0.4
Shanghai Jahwa United Co Ltd	0.4
Others	36.2
Total	**100.0**

Source: Euromonitor(2011), Leading Research Center

4. Why is Chinese into Amore? (2)

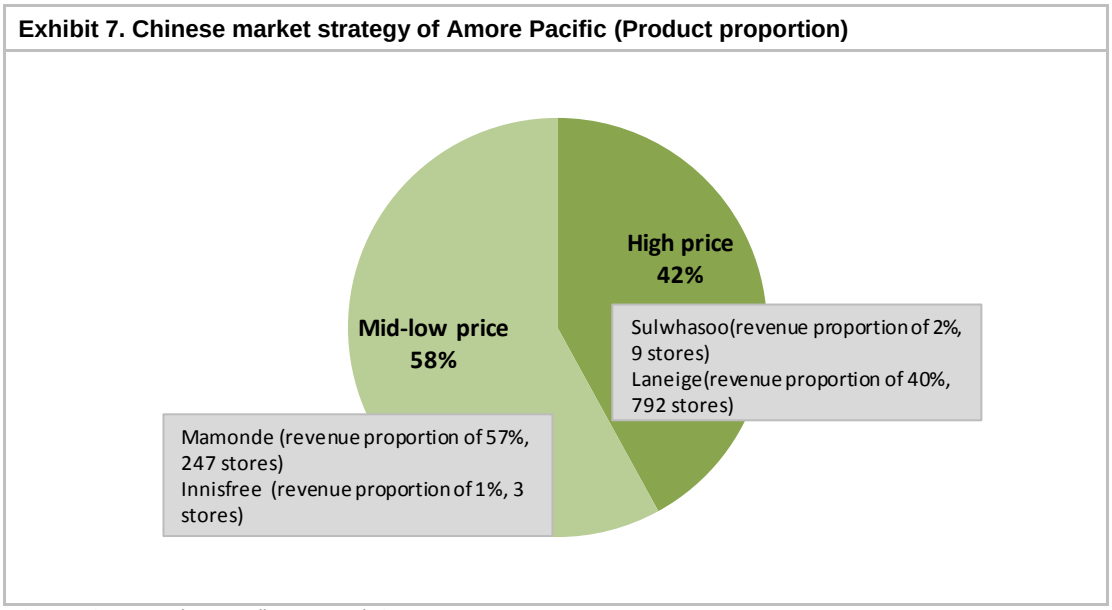
- **Diverse product mix**

In China, major consumers for cosmetics were middle-class in 1st tier cities. Chinese market has grown with luxury cosmetics. Cosmetics consumption increased even in 2nd tier~6th tier cities along with increase in personal income of China. Consumption increases from high-end to low-end cosmetics given the level differential of consumption in 1st tier~6th tier cities.

Amore Pacific has diversified its product base in China (Sulwhasoo- high-end, Laneige- mid-high price, Mamonde- mid-low price, Innisfree- low-end). The company sold Laneige and Mamonde in the early stage of market entry in China. These two brands recorded revenue of W250bn in 2011. The high-end brand, Sulwhasoo, was recently launched in China given income increase of middle class household. The low-end brand, Innisfree, is increasing its sales along with the mid-low price cosmetic boom in China. We believe that Amore Pacific's diverse product mix supports the company's high growth in China.

Exhibit 6. Chinese market expansion of Amore Pacific

Exhibit 7. Chinese market strategy of Amore Pacific (Product proportion)



Source: Company data, Leading Research Center

5. Amore Pacific will explosively grow in 2014

Overseas business: 'fast growth + profitability improvement'

Amore Pacific's overseas sales recorded W327.2bn in 2011 ,which accounted for 12.8% of total sales, and is expected to grow CAGR 28.5% from 2012 to 2014. Driven by fast growth of overseas business, OPM of the overseas division is estimated to improve to 23.3% in 2014 from 0.9% in 2011. As a result, total OPM will be likely to increase to 15.1% in 2014 from 13.8% in 2012.

Construction of Chinese local production line will be completed in 2014

Amore Pacific plans to complete the construction of Asia production factory in Shanghai which has capacity of W1.6tr by 2014. Therefore, the company is able to secure the production, R&D, and logistics system. The company also will secure small quantity production for diverse customized products as well as mass production system for rapid demand increase. The new factory will produce Mamonde and Innisfree. Luxury brands, Sulwhasoo and Laneige, will be exported from Korea. In China, the mid-low price cosmetics market rapidly grows driven by an increase in cosmetics consumption in 2^{nd} tier~6^{th} tier cities. Although competition in the mid-low price cosmetics market becomes intense, we believe that Amore Pacific will be outstanding with the Korean premium in the market.

TOP of the TOP Premium in Korea

The selling strategy of Amore Pacific is 'Luxury'. Consumers want to use high quality cosmetics for their face. As the company's strategy meets consumers' needs, AMORE PACIFIC is in the high ranks of sales in various price categories. This seems that Amore Pacific has a premium as the top cosmetic company in Korea. However, the brand value is not enough under the current market environment which mid-low price cosmetics rapidly grow. In Korean market, revenue increases with product quality rather than brand value. Amore Pacific invests 3% of annual revenue in R&D and produce raw and subsidiary materials via the company's affiliated companies. Therefore, Amore Pacific maintains top of the top product quality and boosts consumers' reliability.

Korean GDP growth marked 3.6% in 2011. On the other hand, the cosmetics market grew 8.2% in 2011. We believe that consumption for high quality cosmetics will increase with economic recovery.

'Cosmeceutical' is the next concept after 'Herbal Cosmetics'

Korean cosmetics market has grown along with the market trend such as 'Herbal cosmetics' in 2009, 'low-end cosmetics' in 2010, and 'Cosmetics copied' in 2011. The upcoming hot cosmetic trend is 'Cosmeceutical (cosmetics + pharmaceutical)'. Demand for cosmeceutical increases annually over 10% and accounts for over 20% of the market in advanced markets such as the U.S and Europe given aging population and the healthy life trend. Although cosmeceutical is not settled in Korean market yet, cosmeceutical products are already sold in the market. Derma cosmetics selling in 'Olive Young', a multi brand shop, and Kiehl's which is a top selling brand in department stores are examples of cosmeceutical products. Especially, Kiehl's generates revenue of W100bn annually. As consumers consider using cosmeceutical products as the other type of medical procedure, product reliability increases on the products.

Amore Pacific also began to enter the cosmeceutical market. The company's medical beauty cosmetic,'Aestura', was launched in June, 2012 through joint development with Pacific Pharma. Aestura, which is sold in only hospitals, has a brand image as a medical product, and its revenue is recognized in Pacific Pharma. Aestura, however, will use Amore Pacific's distribution network in order to expand supply. Aestura is estimated to generate annual revenue of W150bn.

LEADING Research

Amore Pacific (090430 KS)

September 17, 2012

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Leading Traffic Light: Green

Amore Pacific is …

- ✓ No.1 domestic cosmetics manufacturer
- ✓ Producing both high and low price cosmetics (Low price cosmetics are produced by Amore G)

Green light because:

- ✓ Transforming to 'Global Amore Pacific'
- ✓ Entering overseas markets with abundant cash

Growth Potential:

- ➢ Expecting the overseas division to rapidly grow at 28.5% CAGR during 2011~2014F
- ➢ Expected to have price edge and well prepare for the market change when the new factory with 1.6tr production capacity in China is completed

Management and Shareholder Value:

- ➢ The company carried out restructuring of core human resources in early 2012
- ➢ The CFO was appointed to a co-CEO with the will to improve earnings

Value creation:

- ➢ Despite over W300bn CAPEX p.a., AP secures ROIC of 14%~18% with abundant cash and EBITDA of over W500bn in 2012E~2014F

Valuation:

- ➢ No.1 Korean company+ abundant cash+ entry in Asian market with high R&D based products
- ➢ The overseas division growth premium of 15% to domestic cosmetics industry 2013F PER of 20.9x
- ➢ Domestic cosmetics industry PER 20.9x * premium of 15% = target price of W1,430,000

CAVEAT EMPTOR!!! – Watch out for…

- ➢ Decrease in luxury cosmetics sales due to economic recession
  - ✓ Growth of door-to-door sales, which accounts for over 50% of total OP, is showing signs of slow down
  - ✓ The company plans to maintain door-to-door sales through hiring 2000 additional counselors in 2012
    Door-to-door sales to grow 6% yoy in 2012F

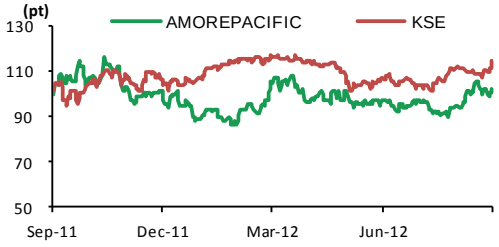
BUY

Target Price (KRW)	**W1,430,000**
Current Price (KRW)	**W1,139,000**
Upside Potential (%)	**25.5%**

Key Data	**September 14, 2012**
Sector	Household Items
KOSDAQ	2,007.6
Market Cap. (Wbn)	6,658.4
Shares Outstanding (m)	5.8
Foreign Ownership (%)	37.6
52 Week High (KRW)	1,295,000
Low (KRW)	964,000
60-davg. turnover (Wbn)	15.6
Major Shareholders	**(%)**
Amore Pacific Group & others	49.5
First State Investment	6.8

Performance (%)	**1M**	**6M**	**12M**
Absolute	8.6	(2.5)	2.6
Relative	6.0	(1.2)	(10.5)

Relative Performance



Valuation Forecast

FY	Sales (Wbn)	% chg yoy	OP (Wbn)	OPM (%)	NP (Wbn)	EPS (W)	EPS Growth (%)	PER (x)	EV/EBITDA (x)	ROE (%)	P/B (x)
2009	1,940.4	15.6	309.2	15.9	225.9	38,639	32.7	24.2	13.9	18.7	5.0
2010	2,252.2	16.1	355.9	15.8	284.5	48,664	25.9	23.4	15.1	20.0	5.1
2011	2,554.7	13.4	372.9	14.6	327.3	55,942	15.0	18.8	13.6	17.8	3.4
2012F	2,882.6	12.8	398.0	13.8	295.9	49,224	(12.0)	22.7	13.0	13.1	3.2
2013F	3,218.6	11.7	463.0	14.4	357.0	59,648	21.2	18.7	10.6	14.0	2.9
2014F	3,623.8	12.6	568.7	15.7	437.0	73,264	22.8	15.2	8.6	15.1	2.5

Amore Pacific (090430 KS)

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Section 1-1: Peer Valuation

Global Peer- Poor earnings of global cosmetics companies due to global recession

Exhibit 9. Global Peer (1)

Company	Country	Sales (USD mn)			Sales Growth(%)		
		11	12E	13E	11	12E	13E
AMOREPACIFIC	SOUTH KOREA	2,308.2	2,494.4	2,772.7	17.4%	8.1%	11.2%
L'OREAL	FRANCE	28,325.9	28,764.9	30,422.0	9.5%	1.5%	5.8%
SHISEIDO CO LTD	JAPAN	8,648.4	8,378.3	9,023.4	10.2%	-3.1%	7.7%
PROCTER & GAMBLE	US	83,680.0	83,894.4	83,935.2	1.4%	0.3%	0.0%
ESTEE LAUDER	US	9,713.6	9,672.2	10,197.4	10.3%	-0.4%	5.4%
BEIERSDORF AG	GERMANY	7,843.4	7,680.5	8,055.8	6.1%	-2.1%	4.9%
SHANGHAI JAHWA-A	CHINA	547.7	684.1	829.1	20.8%	24.9%	21.2%
JOHNSON&JOHNSON	US	65,030.0	67,066.3	71,909.2	5.6%	3.1%	7.2%
AVON PRODUCTS	US	11,291.6	10,726.2	10,877.8	3.9%	-5.0%	1.4%
UNILEVER NV-CVA	NETHERLANDS	64,701.0	66,088.8	70,105.1	10.2%	2.1%	6.1%
LVMH MOET HENNES	FRANCE	32,943.0	36,171.0	39,365.2	22.2%	9.8%	8.8%
KOSE CORP	JAPAN	2,110.3	2,050.4	2,182.1	5.4%	-2.8%	6.4%
FANCL CORP	JAPAN	1,117.4	1,106.0	1,096.4	1.8%	-1.0%	-0.9%
HENGAN INTL	CHINA	2,190.4	2,572.5	3,166.7	26.7%	17.4%	23.1%

Source: Bloomberg, Leading Research Center (2012.09.13)

Global Peer average 2013F PER 18.6X

Exhibit 10. Global Peer (2)

Name	Code	Market Cap (Wbn)	OP Margin (%)				P/E (X)				ROE (X)			
			10	11	12E	13E	10	11	12E	13E	10	11	12E	13E
AMOREPACIFIC COR	090430 KS	5,951.9	16.0	14.6	14.2	14.5	27.3	22.2	23.5	20.3	17.9	16.1	14.2	14.3
L'OREAL	OR FP	72,643.1	15.7	16.2	16.1	16.4	21.7	19.6	20.5	18.9	16.1	15.5	15.5	15.4
SHISEIDO CO LTD	4911 JP	5,745.9	6.6	5.7	6.1	6.0	44.8	39.2	23.8	20.3	4.3	4.9	6.1	8.0
PROCTER & GAMBLE	PG US	184,411.9	19.2	17.8	17.9	18.7	16.1	15.9	18.1	17.7	18.4	17.2	16.5	17.5
ESTEE LAUDER	EL US	23,261.2	13.4	14.3	14.1	15.1	27.5	23.5	26.9	23.6	33.6	34.0	32.5	33.7
BEIERSDORF AG	BEI GR	18,032.4	11.8	10.0	11.8	13.1	29.7	39.8	27.6	24.5	12.4	11.3	14.6	15.3
SHANGHAI JAHWA-A	600315 CH	2,975.7	7.8	9.5	14.0	14.1	57.1	40.1	40.4	32.6	19.0	21.2	22.5	23.3
JOHNSON&JOHNSON	JNJ US	185,300.7	26.8	24.8	26.2	26.8	13.0	13.1	13.6	12.6	24.8	24.4	23.5	22.6
AVON PRODUCTS	AVP US	6,671.1	9.9	9.9	5.8	6.8	16.1	10.3	20.3	16.4	53.6	45.7	23.4	30.1
UNILEVER NV-CVA	UNA NA	103,928.5	15.0	13.8	13.8	14.1	15.4	17.6	17.1	15.7	33.5	32.0	29.6	28.4
LVMH MOET HENNES	MC FP	82,166.4	21.3	22.2	21.3	21.8	19.4	17.4	16.9	15.1	20.3	15.8	15.7	15.6
KOSE CORP	4922 JP	1,410.5	8.1	6.9	6.5	7.1	17.8	21.7	21.2	15.4	7.0	4.9	4.5	6.3
FANCL CORP	4921 JT	760.6	7.6	4.6	4.8	4.8	26.5	29.5	25.2	29.7	3.9	3.8	3.0	2.5
HENGAN INTL	1044 HK		21.0	18.3	22.0	21.8	33.6	33.6	27.0	22.0	25.0	23.3	26.2	28.6

Source: Bloomberg, Leading Research Center (2012.09.13)

Domestic Peer- high valued to the global cosmetics market

Exhibit 11. Domestic Peer

Name	Ticker	Market Cap	Sales Growth (yoy %)			OP Margin		
			11	12E	13E	11	12E	13E
Amore Pacific	002790 KS	3,119.3	19.4	11.1	14.4	14.2	14.1	14.7
LG H&H	051900 KS	8,259.6	27.6	12.6	11.5	10.4	12.1	12.7
Able C&C	078520 KS	659.8	31.3	35.9	22.5	10.9	13.8	14.0
Genic	123330 KS	242.1	19.8	14.5	25.0	13.1	14.0	15.2
Cosmax	044820 KS	436.1	32.4	26.0	22.9	6.9	8.5	8.8
Kolmar Korea	024720 KS	315.4	24.0	(13.5)	26.1	6.5	5.5	6.4
Bioland	052260 KS	203.0	13.6	31.2	26.3	23.1	21.5	21.5

Name	Ticker	P/E			EV/EBITDA			P/B			ROE		
		11	12E	13E	11	12E	13E	11	12E	13E	11	12E	13E
Amore Pacific	090430 KS	22.2	23.5	20.3	13.0	12.4	10.8	2.9	3.2	2.8	16.1	14.2	14.3
LG H&H	051900 KS	30.9	31.5	26.3	17.0	17.7	15.0	7.2	9.3	7.2	28.2	28.6	27.0
Able C&C	078520 KS	9.8	16.6	13.2	4.9	10.7	8.2	2.4	5.0	3.7	27.9	34.4	32.3
Genic	123330 KS	14.2	19.9	14.5	11.1	13.6	10.0	4.1	4.5	3.4	35.3	25.2	26.6
Cosmax	044820 KS	18.4	25.1	20.3	12.6	17.3	13.6	3.5	6.5	5.1	22.3	28.6	27.7
Kolmar Korea	024720 KS	22.0	24.6	20.0	14.6	18.9	15.9	2.1	3.2	2.8	10.5	12.5	14.8
Bioland	052260 KS	17.2	19.1	12.0	12.2	10.1	7.5	2.5	2.3	2.0	16.6	12.6	17.5

Source: Bloomberg, Leading Research Center (2012.09.13)

Section 1-2 : Target price of W1,430,000

Giving domestic 2013F IND PER 20.9X * PREMIUM 15%

Amore Pacific (AP) manufactures high to mid price cosmetics except low price cosmetics, which is produced by Amore G. As the low price cosmetic market is growing fast and leads total cosmetic market, earnings growth of AP slows down. However, the company is trying to release new product and hire additional door-to-door counselors to maintain stable revenue in sales of luxury cosmetics, which has the highest operating margin.

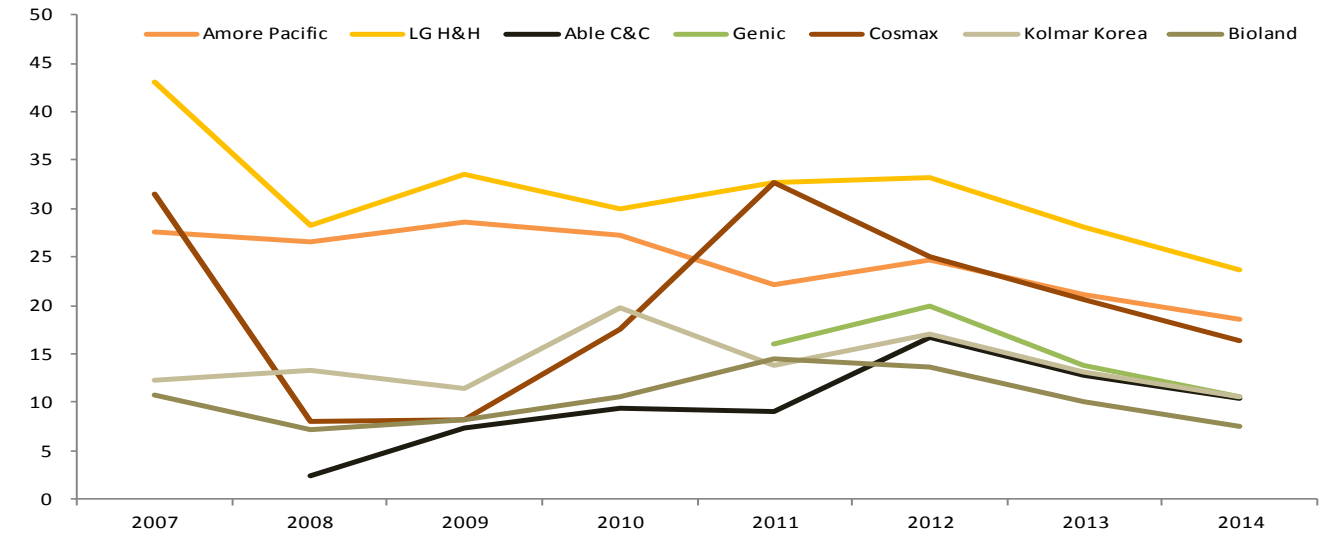
A future growth engine of AP is overseas division, which is expected to grow 28.5% per annum for next 3 years. Backed by Korean wave across the world, Amore Pacific also improves its brand image. The preference of AP is shown in figure of duty-free shops, which foreigner proportion is over 60%, increases 30% annually. AP is penetrating China market through Increasing number of stores and supplying high quality products in reasonable price. Based on abundant cash, the company has entered many markets such as China, Japan, Malaysia, Taiwan, and Singapore.

Global peer companies receive premiums on overseas sales growth base on their revenues in each domestic market. Therefore, we believe that Amore Pacific should receive a premium as No.1 domestic cosmetic company. The company's overseas sales accounts for 12.8% of the total revenue and will increase 28.5% annually for next 3 years.

Applying domestic cosmetic industry 2013F PER of 20.9x with the premium of 5%, we derive the target price of W1,430,000.

Amore Pacific 2013F EPS of W59,648 * domestic cosmetic industry 2013F PER of 20.9X * 15% =W1,430,000

Exhibit 12. Domestic Peer PER Band



Source: Bloomberg, Data guide, Leading Research Center (2012.09.13)

Section 2: Operations overview

Amore Pacific is...

No.1 domestic cosmetic manufacturer

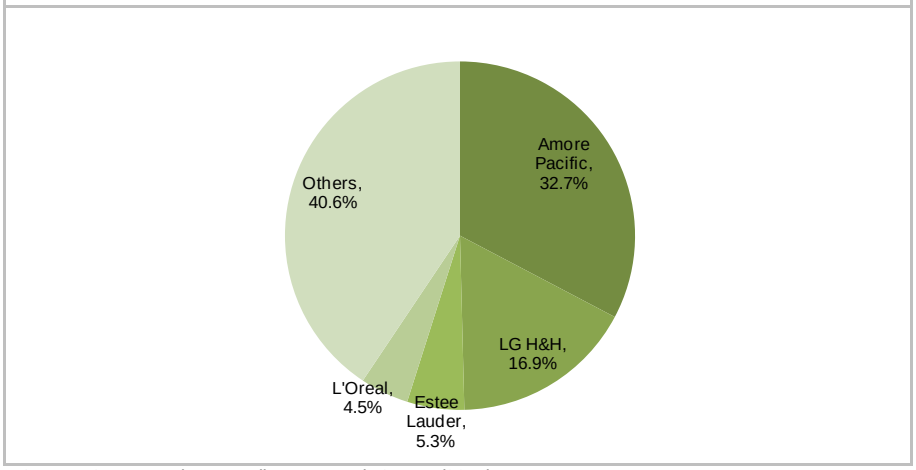
Amore Pacific is the domestic No.1 cosmetic company, having market share of 32.7%. The main brand, Sulwhasoo, is sold in department store and mid-low price cosmetics (Iope, Mamonde etc)are sold in Aritaum which is a own brand shop. Overseas revenue accounts for 12.8% of the total revenue driven by the Korean wave across the world.

Exhibit 13. Amore Pacific's consolidated revenue proportion by brand

(Consolidated)	Proportion	Sales channel	Brand
(Domestic) Luxury	44.8%	Department store, door-to-door sales	Sulwhasoo, Amore Pacific, Hera
(Domestic) Mid-low price	26.7%	Specialty store, discount store, online	Iope, Laneige, Mamonde, Hannule, Lirikos
(Domestic) Hair, body, tea	15.8%	Department store, discount store	O'sulloc, Miseenscene, Median, Happybath
(Overseas) Cosmetics	12.8%	Department store, discount store	Laneige, Mamonde, Sulwhasoo, Innisfree

Source: Company data(2011), Leading Research Center

Exhibit 14. Domestic market share



Source: Company data, Leading Research Center (2011)

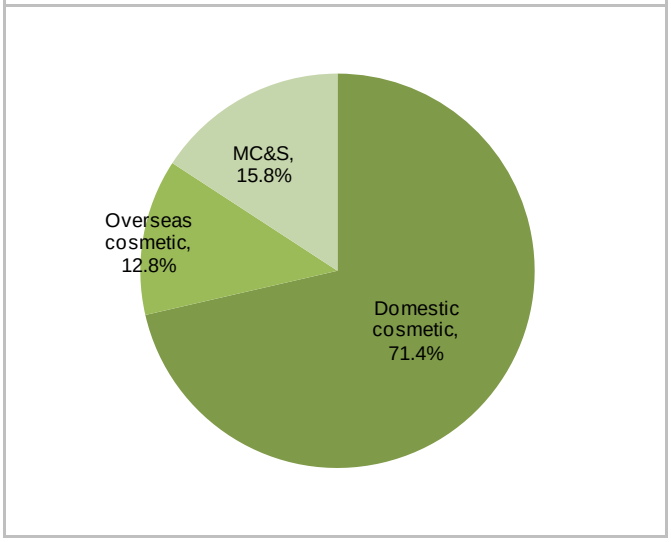
Exhibit 15. Production capacity and operation rate

(Wbn)	Production CAPA	2011 operation rate	Location
Domestic-cosmetics	**2,406**		
Skincare	2,018	72%	Osan
Makeup	388	87%	Osan
Domestic -MC&S	**1,201**		
Soap, toothpaste	1,084	73%	Daejeon
Green tea	117	66%	Jincheon
China- cosmetics	**110**	**100%**	**Shanghai**

Source: Company data (2011), Leading Research Center

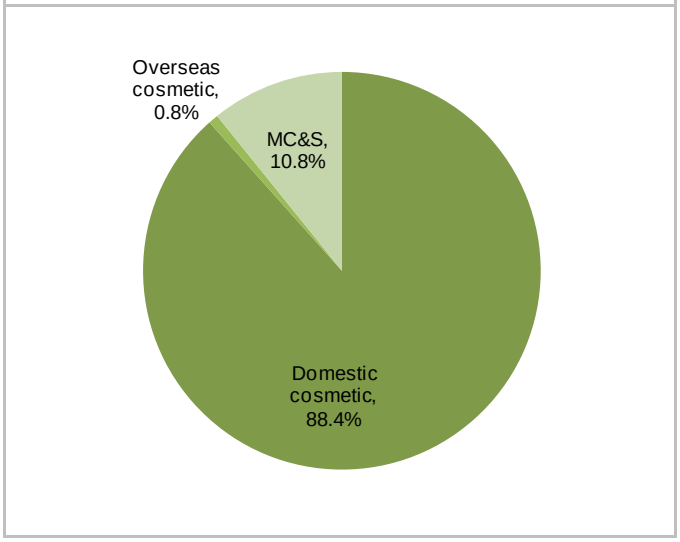
78% of OP is comprised of luxury cosmetics

Exhibit 16. Sales Breakdown



Source: Company data(2011), Leading Research Center

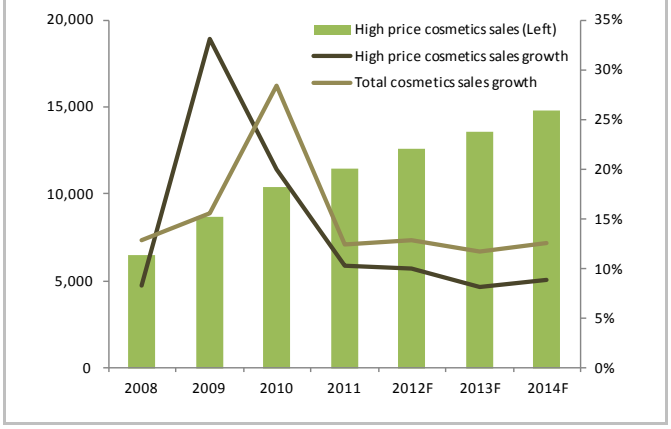
Exhibit 17. OP Breakdown



Source: Company data(2011), Leading Research Center

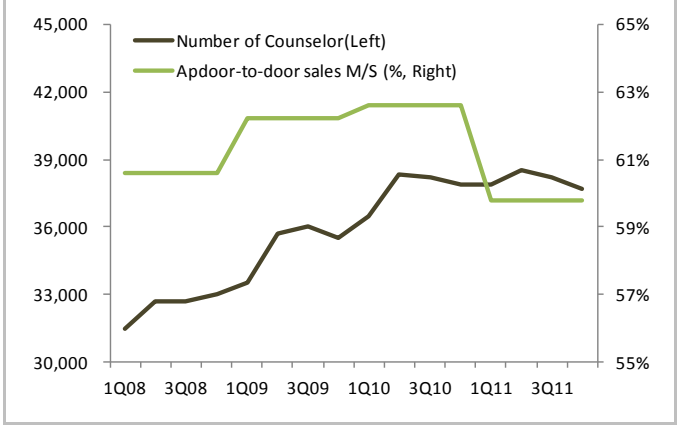
Luxury cosmetics growth of +10% yoy in 2012F in line with an increase of counselors

Exhibit 18. Luxury cosmetics account for 63% of AP sales



Source: Company data, Leading Research Center

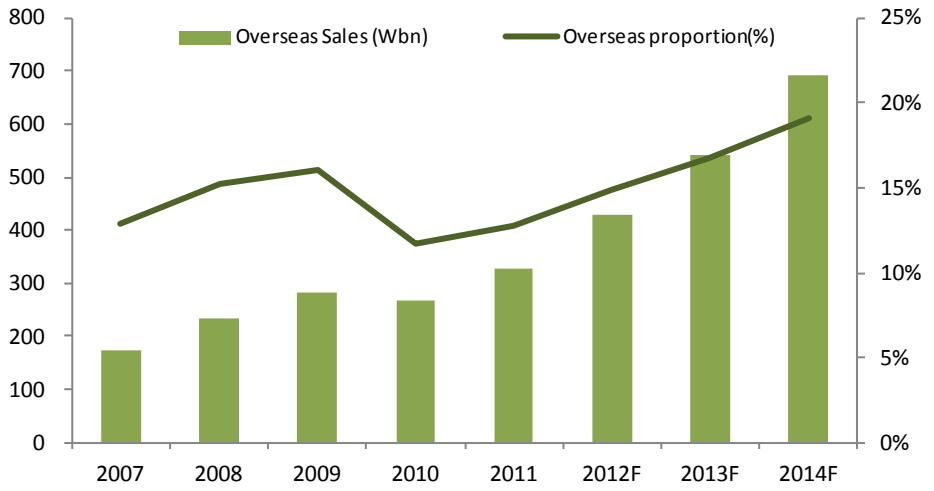
Exhibit 19. Door-to-door counselors and M/S



Source: Company data, Leading Research Center

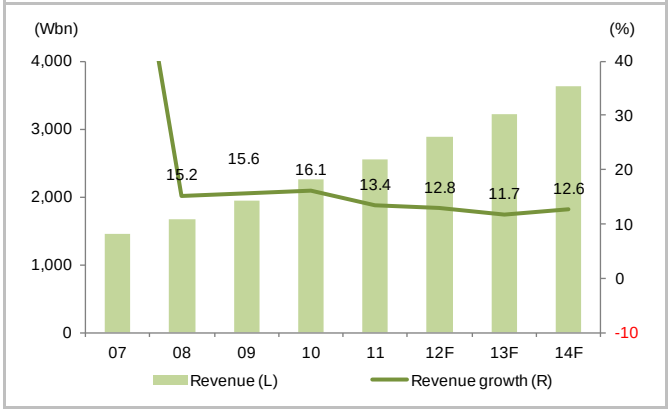
Overseas business is the company's growth engine

Exhibit 20. Domestic market share



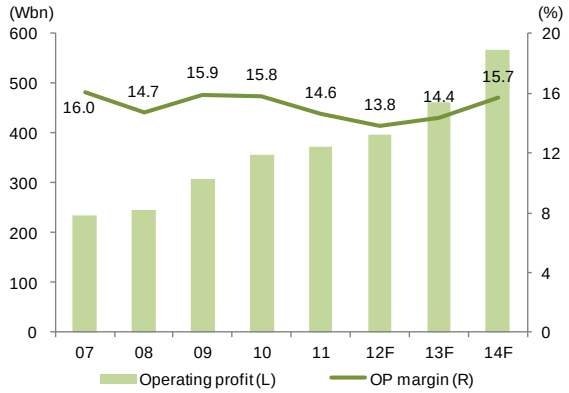
Source: Company data, Leading Research Center

Exhibit 21. Revenue and Growth trend



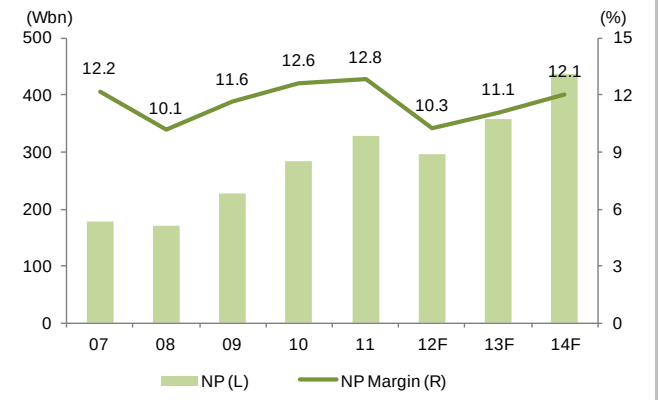
Source: Company data, Leading Research Center

Exhibit 22. Operating profit and OPM trend



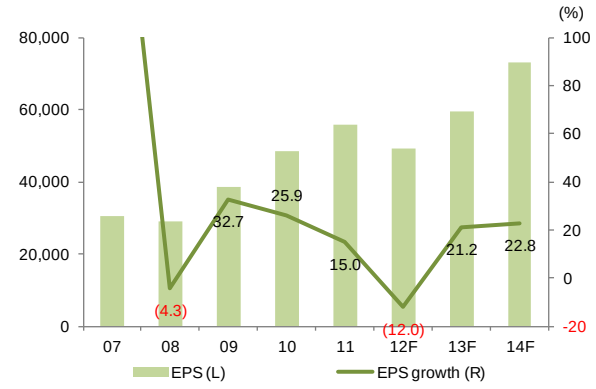
Source: Company data, Leading Research Center

Exhibit 23. Net profit and NP margin trend



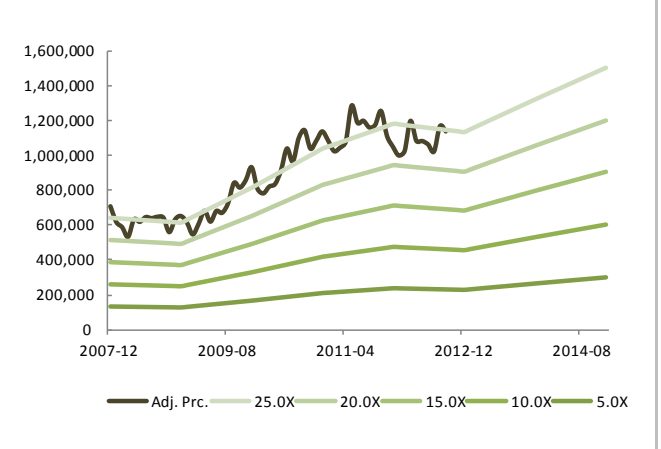
Source: Company data, Leading Research Center

Exhibit 24. EPS and EPS growth



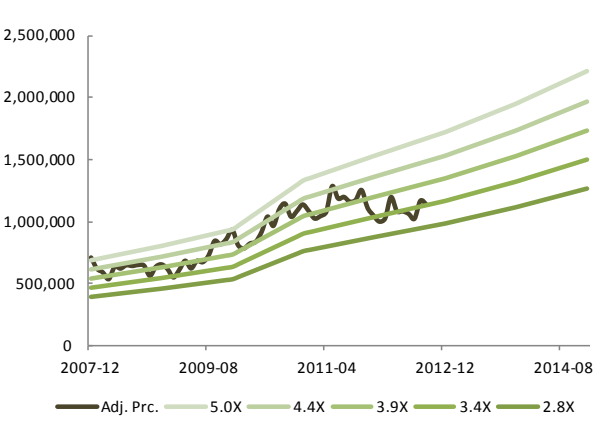
Source: Company data, Leading Research Center

Exhibit 25. PER BAND



Source: Company data, Leading Research Center

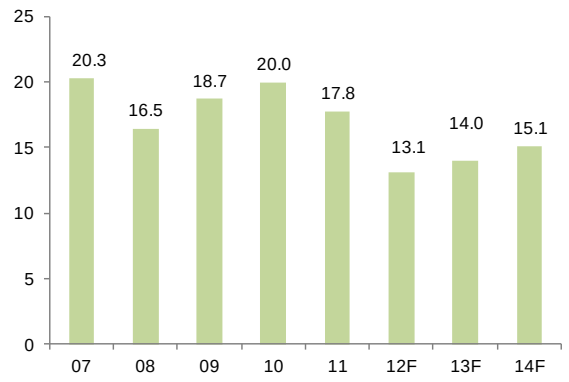
Exhibit 26. PBR BAND



Source: Company data, Leading Research Center

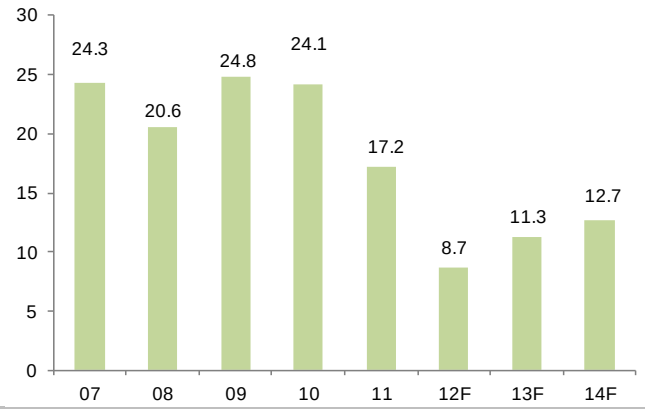
Section 3: Is the company a value creator?

Exhibit 27. ROE (%)



Source: Company data, Leading Research Center

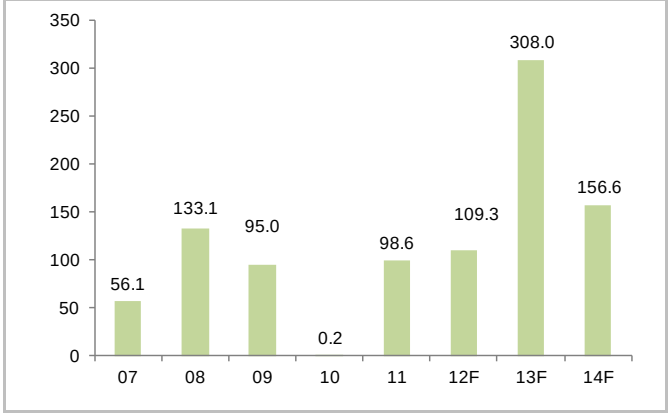
Exhibit 28. EVA: ROIC less WACC (%)



Source: Company data, Leading Research Center

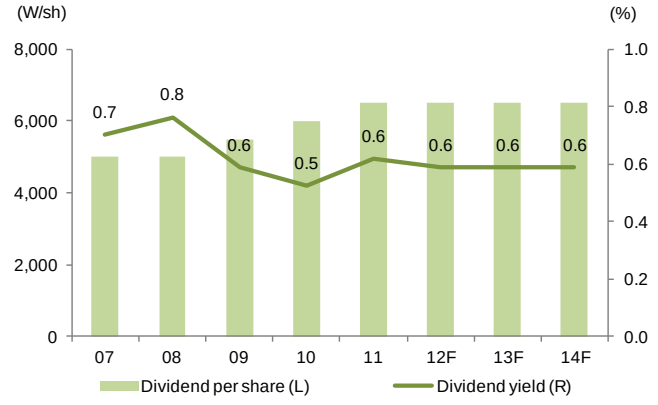
Section 4: Free cashflow generation and dividend policy

Exhibit 29. Free Cash Flow trend (Wbn)



Source: Company data, Leading Research Center

Exhibit 30. Dividend per share and yield trend



Source: Company data, Leading Research Center

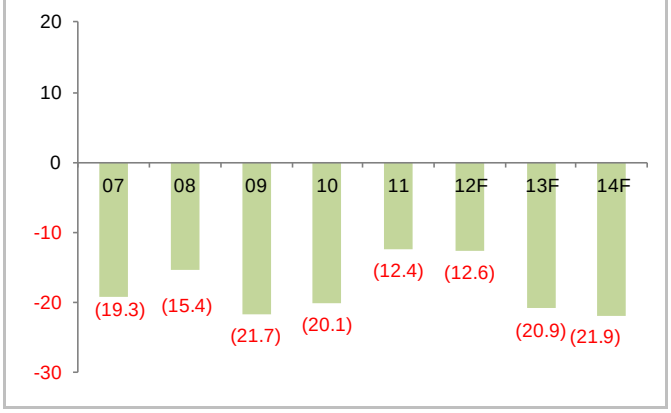
Exhibit 31. Dividends per share and dividend rate trend

(Wbn)	07	08	09	10	11	12F	13F	14F
Cash from operation	222.5	229.3	357.6	364.1	403.0	322.5	645.4	551.0
CAPEX	176.3	206.6	201.8	310.4	316.8	234.1	291.2	339.6
Free cash flow	3.7	78.6	107.7	-34.5	80.5	109.3	308.0	156.6
Total dividend	31.1	34.5	34.6	38.0	41.4	44.9	44.9	45.0
Dividend/shr (W/shr)	5,000	5,000	5,500	6,000	6,500	6,510	6,520	6,530
Dividend yield(%)	0.7	0.8	0.6	0.5	0.6	0.6	0.6	0.6

Note: Dividend yield on last price of the year
Source: Company data, Leading Research Center

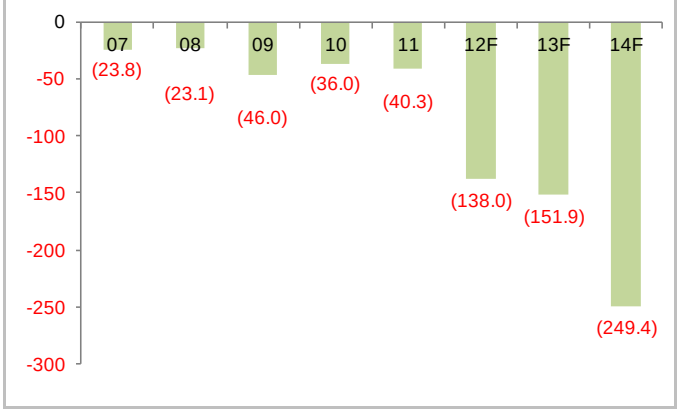
Section 5: Are the debt and interest burden manageable?

Exhibit 32. Net debt/equity ratio (%)



Source: Company data, Leading Research Center

Exhibit 33. Interest coverage (X)



Source: Company data, Leading Research Center

Exhibit 34. Interest bearing debt and interest coverage trend

(Wbn)	07	08	09	10	11	12F	13F	14F
Interest bear debt	19.3	25.5	20.4	13.3	77.2	69.8	55.8	44.3
Cash & equivalents	203.3	197.4	302.5	325.7	343.4	371.1	613.7	698.6
Net int bearing debt	(184.0)	(171.9)	(282.1)	(312.4)	(266.2)	(301.3)	(557.9)	(654.3)
Net debt/equity (%)	(19.3)	(15.4)	(21.7)	(20.1)	(12.4)	(12.6)	(20.7)	(21.2)
Net interest	1.8	2.3	2.5	1.7	1.9	2.7	8.8	7.0
Interest coverage (x)	(23.8)	(23.1)	(46.0)	(36.0)	(40.3)	(138.0)	(151.9)	(249.4)

Source: Company data, Leading Research Center

Section 6: Asking for money with share issues, CB&BW?

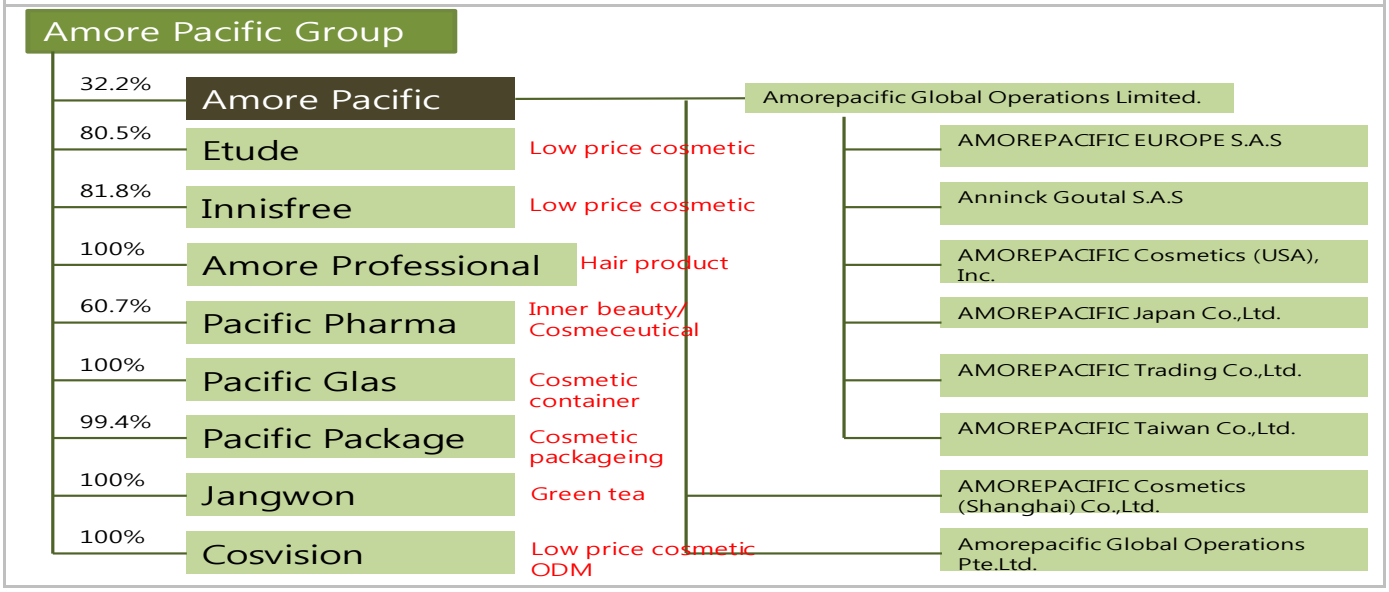
Exhibit 35. Capital raised through stock issuance

(Wbn)	06	07	08	09	10	11	INCR. DR 2006-2011
Paid-in capital	34.5	34.5	34.5	34.5	34.5	34.5	0.0
Paid-in cap in excess of par	712.7	712.7	712.7	712.7	719.4	720.4	7.7
Capital raised through stock issue	747.2	0.0	0.0	0.0	6.7	1.0	754.9

Source: Company data, Leading Research Center

Section 7: What is management philosophy?

Exhibit 36. Amore Pacific Group structure



Source: Company data, Leading Research Center

Unusual movement of Amore Pacific

Uncertainty has grown due to economic recession and intense competition

The luxury strategy has weakened due to the low-end cosmetic boom as well as ongoing recession. Sulwhasoo recorded poor earnings given intense competition in the herbal cosmetic market and recession. The CEO, Kyung Bae Seo, plans to restructure human resources to overcome this crisis.

The CEO's decision to overcome the crisis is restructuring

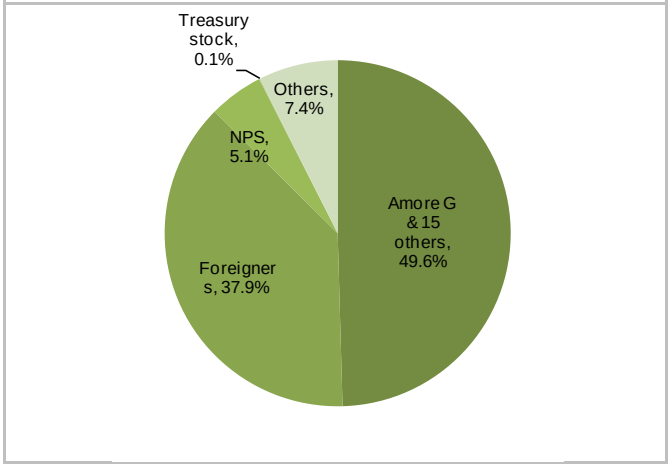
AP is restructuring 35 board members.Hee Sun Kim, an ex-executive director, who is well-known person in the industry, moved to another herbal cosmetic supplier, KT&G. The main reason of restructuring is for earnings upgrade. Amore Pacific recorded revenue growth of +9% yoy, OP growth of +3% yoy, and NP growth of -6% yoy in 1H12 under difficult market condition.

Expecting 2014

Women are moved by product quality over brand power

Amore Pacific is expected to grow as 'Global Amore Pacific' over domestic No.1 cosmetic company. The company has tried to enter new market through product quality rather than marketing based on the high-grade strategy. By this strategy, the company grew annually 41.6% for last 4 years in China and will likely grow over 30% annually. The main target of the strategy to touch customers' heart is women regardless their nationalities or races. We believe that the company will succeed as the company has done in Korea.

Exhibit 37. Shareholders



Source: Company data, Leading Research Center

Section 8: Earnings forecast

Basic assumption

1. Growth in luxury cosmetics : 5.6%
2. Growth in overseas sales : 28.5%

Exhibit 38. Annual earnings forecast

	Sales (Wbn)				Growth (%)			
	2011	2012F	2013F	2014F	2011	2012F	2013F	2014F
Revenue	2,554.7	2,882.6	3,218.6	3,623.8	13.4%	12.8%	11.7%	12.6%
Gross profit	1,780.1	2,025.1	2,263.0	2,542.7	6.4%	13.8%	11.8%	12.4%
Adj. OP	372.9	398.0	463.0	568.7	4.8%	6.7%	16.3%	22.8%
NP	327.3	295.9	357.0	437.0	15.0%	-9.6%	20.7%	22.4%
EPS	55,942	49,224	59,648	73,264	15.0%	-12.0%	21.2%	22.8%
OPM (%)	14.6%	13.8%	14.4%	15.7%				
NPM (%)	12.8%	10.3%	11.1%	12.1%				

Source: Company data, Leading Research Center

Exhibit 39. Quarterly earnings forecast

	2012F Sales				2012F Growth (% yoy)			
	1Q	2Q	3QF	4QF	1Q	2Q	3QF	4QF
Revenue	741.5	726.8	683.8	730.5	7.1%	11.5%	9.8%	24.2%
Gross profit	528.8	520.8	467.0	508.4	10.3%	11.9%	10.4%	23.5%
Adj. OP	150.4	98.1	61.0	88.4	1.6%	4.9%	-20.3%	61.5%
NP	114.0	59.1	50.9	71.9	1.1%	-17.6%	-20.1%	-9.1%
EPS	20.3%	13.5%	8.9%	12.1%				
OPM (%)	15.4%	8.1%	7.5%	9.8%				

Source: Company data, Leading Research Center

Exhibit 40. Revenue outlook by sales channel

(Wbn)	2010	2011	2012F	2013F	2014F
Total sales	**2,538.8**	**2,554.6**	**2,882.6**	**3,218.6**	**3,623.8**
Cosmetics	1,922.8	2,152.1	2,429.7	2,709.2	3,050.7
Domestic	1,656.2	1,824.9	2,001.2	2,168.9	2,357.0
Department store	423.1	500.9	576.0	662.4	761.8
Door-to-door sales	614.2	642.8	681.4	697.7	719.4
Specialty store	270.9	305.3	334.0	358.4	378.4
Discount store	173.7	173.1	167.9	162.9	158.0
Online	123.3	148.4	183.9	225.6	273.4
Direct sales	35.1	37.0	38.9	40.8	42.8
Others	15.9	17.4	19.1	21.1	23.2
Overseas	266.6	327.2	428.6	540.4	693.7
China	142.4	190.8	262.2	346.8	467.3
France	97.5	100.4	110.6	122.6	136.6
U.S	12.0	15.8	16.1	16.4	17.3
Asia(Taiwan, Hong Kong, Malaysia)	39.5	47.2	59.7	74.5	92.6
Revenue revision	(24.8)	(27.0)	(20.0)	(20.0)	(20.0)
MC&S	349.4	402.5	452.8	509.4	573.1
Total sales	**43.5%**	**0.6%**	**12.8%**	**11.7%**	**12.6%**
Cosmetics	30.4%	11.9%	12.9%	11.5%	12.6%
Domestic	39.0%	10.2%	9.7%	8.4%	8.7%
Department store	39.1%	18.4%	15.0%	15.0%	15.0%
Door-to-door sales	9.5%	4.7%	6.0%	2.4%	3.1%
Specialty store	1.4%	12.7%	9.4%	7.3%	5.6%
Discount store	6.7%	-0.3%	-3.0%	-3.0%	-3.0%
Online	N/A	20.4%	23.9%	22.7%	21.2%
Direct sales	N/A	5.4%	5.0%	5.0%	5.0%
Others	N/A	9.4%	10.0%	10.0%	10.0%
Overseas	-5.8%	22.7%	31.0%	26.1%	28.4%
China	21.1%	34.0%	37.4%	32.3%	34.7%
France	0.4%	3.0%	10.2%	10.8%	11.4%
U.S	4.3%	31.7%	2.0%	2.0%	5.0%
Asia(Taiwan, Hong Kong, Malaysia)	-30.5%	19.5%	26.4%	24.9%	24.3%
Revenue revision	N/A	N/A	N/A	N/A	N/A
MC&S	18.6%	15.2%	12.5%	12.5%	12.5%

Source: Company data, Leading Research Center

Financial Statement

Income statement

(Wbn)	07	08	09	10	11	12F	13F	14F
Revenue	**1,457.4**	**1,678.3**	**1,940.4**	**2,252.2**	**2,554.7**	**2,882.6**	**3,218.6**	**3,623.8**
% chg yoy	85.1	15.2	15.6	16.1	13.4	12.8	11.7	12.6
COGS	**430.0**	**498.4**	**539.3**	**578.4**	**774.6**	**857.5**	**955.6**	**1,081.1**
Gross profit	**1,027.4**	**1,180.0**	**1,401.2**	**1,673.7**	**1,780.1**	**2,025.1**	**2,263.0**	**2,542.7**
GP margin (%)	70.5	70.3	72.2	74.3	69.7	70.3	70.3	70.2
SG&A	**793.5**	**933.6**	**1,092.0**	**1,317.8**	**1,407.2**	**1,627.1**	**1,800.0**	**1,974.0**
Operating income	**233.9**	**246.4**	**309.2**	**355.9**	**372.9**	**398.0**	**463.0**	**568.7**
Adj. OP margin (%)	16.0	14.7	15.9	15.8	14.6	13.8	14.4	15.7
Net other income	**0.0**	**(0.0)**	**0.0**	**0.0**	**(0.0)**	**0.0**	**0.0**	**0.0**
Reported OP	**233.9**	**246.4**	**309.2**	**355.9**	**372.9**	**398.0**	**463.0**	**568.7**
Net equity method gains	**(7.8)**	**(6.4)**	**(10.5)**	**(13.5)**	**1.0**	**1.0**	**0.7**	**0.7**
Financial income	29.1	36.5	24.5	34.0	76.0	26.8	31.8	29.3
Financial expenses	9.4	23.9	23.4	15.5	20.3	21.4	26.8	25.0
Income before tax	**245.9**	**252.6**	**299.8**	**360.9**	**429.6**	**404.4**	**468.7**	**573.7**
Income tax	66.7	68.4	73.9	76.5	102.4	108.6	111.7	136.7
Tax rate (%)	27.1	27.1	24.7	21.2	23.8	26.8	23.8	23.8
Net profit	**177.9**	**170.2**	**225.9**	**284.5**	**327.3**	**295.9**	**357.0**	**437.0**
Controlling interest	177.9	170.2	225.9	284.5	327.0	294.7	355.6	435.2
Non-controlling	0.0	0.0	0.0	0.0	0.2	1.2	1.4	1.7
Other comprehensive inc	8.8	26.7	(6.9)	(4.1)	(22.8)	(1.9)	0.0	0.0
Total comprehensive inc	**186.6**	**197.0**	**219.0**	**280.4**	**304.5**	**294.0**	**357.0**	**437.0**

Balance sheet

(Wbn)	07	08	09	10	11	12F	13F	14F
Current assets	**487.6**	**527.1**	**636.4**	**704.2**	**753.7**	**1,056.2**	**1,176.4**	**1,341.1**
Cash & equivalents	114.2	154.4	219.8	155.3	187.7	214.6	463.7	563.8
ST financial assets	89.2	43.0	82.7	170.4	155.7	156.5	156.5	156.5
Accounts receivables	113.2	139.4	157.1	153.2	166.3	208.1	236.7	264.9
Inventory	136.3	173.0	160.1	204.4	225.8	240.2	273.1	305.7
Others	34.8	17.3	16.8	20.8	18.2	236.8	46.5	50.3
Non-current assets	**849.3**	**1,011.0**	**1,117.7**	**1,320.3**	**2,061.7**	**2,027.1**	**2,234.7**	**2,481.5**
Tangible Assets	694.4	834.9	939.7	1,155.9	1,655.5	1,766.3	1,927.0	2,118.4
Inv in related co's	14.0	15.1	25.3	28.1	13.9	11.2	12.2	13.2
Intangible Assets	31.5	23.5	27.3	29.7	115.2	125.8	139.2	152.7
Others	109.3	137.4	125.4	106.5	277.2	123.8	156.3	197.3
Total assets	**1,336.8**	**1,538.1**	**1,754.1**	**2,024.4**	**2,815.4**	**3,083.3**	**3,411.1**	**3,822.6**
Current liabilities	**223.6**	**253.4**	**282.8**	**303.1**	**426.0**	**422.5**	**423.5**	**428.8**
Accounts payables	133.8	154.5	200.4	79.9	78.0	80.1	91.0	101.9
ST financial liabilities	19.3	25.5	20.4	13.3	15.6	22.6	12.6	7.1
Others	70.4	73.4	62.0	209.9	332.4	319.8	319.8	319.8
Non-current liabilities	**160.0**	**169.4**	**171.6**	**163.4**	**251.1**	**273.5**	**288.2**	**302.4**
LT payables	21.6	25.7	22.1	18.0	0.0	0.0	0.0	0.0
LT financial liabilities	0.0	0.0	0.0	0.0	61.7	47.2	43.2	37.2
Others	138.3	143.7	149.5	145.4	189.5	226.4	245.0	265.2
Total liabilities	**383.5**	**422.8**	**454.4**	**466.5**	**677.1**	**696.0**	**711.7**	**731.2**
Paid-in capital	34.5	34.5	34.5	34.5	34.5	34.5	34.5	34.5
Capital surplus	712.7	712.7	712.7	719.4	720.4	720.5	720.5	720.5
Others	3.2	29.5	22.6	18.5	(4.2)	(6.1)	(6.1)	(6.1)
Retained earnings	202.9	338.6	529.9	776.4	1,377.4	1,627.7	1,939.8	2,331.8
Non-controlling interest	0.0	0.0	0.0	9.2	10.2	10.7	10.7	10.7
Total shareholder equity	**953.3**	**1,115.3**	**1,299.7**	**1,558.0**	**2,138.3**	**2,387.3**	**2,699.4**	**3,091.4**

Free cashflow analysis

(Wbn)	07	08	09	10	11	12F	13F	14F
Net profit	**177.9**	**170.2**	**225.9**	**284.5**	**327.3**	**295.9**	**357.0**	**437.0**
Adj. for non-cash exp.	**97.1**	**113.7**	**118.9**	**114.2**	**145.7**	**102.7**	**148.5**	**167.8**
Depreciation	66.7	75.9	85.7	84.9	81.6	102.8	130.5	148.3
Provision for reserves	(0.1)	0.7	(0.3)	0.2	1.2	0.0	0.0	0.0
Net FX gains	(7.8)	(6.4)	(10.5)	(13.5)	1.0	0.3	0.7	0.7
Net eq method gains	22.5	32.0	22.4	16.1	66.3	0.3	18.7	20.2
Chg in op assets & liab	**(52.4)**	**(54.5)**	**12.8**	**(34.6)**	**(18.2)**	**(30.3)**	**139.8**	**(53.8)**
Incr in WC (decr)	(37.8)	(91.0)	(57.9)	(59.8)	(20.4)	47.9	(72.5)	(71.7)
Others	90.2	145.6	45.2	94.5	38.6	(17.6)	(67.3)	125.4
Cash from operations	**222.5**	**229.3**	**357.6**	**364.1**	**403.0**	**322.5**	**645.4**	**551.0**
Capital expenditures	176.3	206.6	201.8	310.4	316.8	234.1	291.2	339.6
Free cash flow	**3.7**	**78.6**	**107.7**	**-34.5**	**80.5**	**109.3**	**308.0**	**156.6**
Dividend	31.1	34.5	34.6	38.0	41.4	44.9	44.9	45.0
Incr in investment assets	0.4	0.3	(0.1)	(3.1)	1.9	4.9	(0.3)	(0.3)
Share issues	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Increase in debt	(5.2)	0.6	(6.1)	(5.2)	44.6	8.3	(14.0)	(11.5)
Others	(39.7)	51.8	(49.9)	(78.1)	(59.0)	(20.1)	(46.4)	(55.1)
Net cash flow	**(30.1)**	**40.2**	**65.4**	**(64.5)**	**28.6**	**26.9**	**249.1**	**100.1**
Beginning cash	144.3	114.2	154.4	219.8	159.1	187.7	214.6	463.7
Ending cash	114.2	154.4	219.8	155.3	187.7	214.6	463.7	563.8

Stability ratios

	07	08	09	10	11	12F	13F	14F
Current ratio	218.1	208.0	225.1	232.3	176.9	250.0	277.8	312.7
Quick ratio	157.1	139.8	168.5	164.9	123.9	193.1	213.3	241.5
Inv. holding period (d)	30	34	31	30	31	30	29	29
A/R collection period (d)	29	27	28	25	23	24	25	25
A/P period (days)	31	31	33	23	11	10	10	10
Interest bear debt (Wbn)	19.3	25.5	20.4	13.3	77.2	69.8	55.8	44.3
Cash & equivalents	203.3	197.4	302.5	325.7	343.4	371.1	620.1	720.2
Net int. bear debt (Wbn)	(184.0)	(171.9)	(282.1)	(312.4)	(266.2)	(301.3)	(564.4)	(676.0)
Net debt/equity (%)	(19.3)	(15.4)	(21.7)	(20.1)	(12.4)	(12.6)	(20.9)	(21.9)
Liability/equity (%)	40.2	37.9	35.0	29.9	31.7	29.2	26.4	23.7
Interest coverage (X)	(23.8)	(23.1)	(46.0)	(36.0)	(40.3)	(138.0)	(151.9)	(249.4)

Valuations and Margins

	07	08	09	10	11	12F	13F	14F
EV/EBITDA (X)	14.0	11.8	13.9	15.1	13.6	13.0	10.6	8.6
EPS (W)	30,424	29,121	38,639	48,664	55,942	49,224	59,648	73,264
EPS yoy chg (%)	217.0	(4.3)	32.7	25.9	15.0	(12.0)	21.2	22.8
PER (X)	23.3	22.5	24.2	23.4	18.8	22.7	18.7	15.2
BVPS (W)	138,124	161,600	188,320	224,407	308,344	344,346	389,572	446,370
P/BVPS (X)	5.1	4.0	5.0	5.1	3.4	3.2	2.8	2.5
Dividend/sh (W)	5,000	5,000	5,500	6,000	6,500	6,510	6,520	6,530
Dividend yield (%)	0.7	0.8	0.6	0.5	0.6	0.6	0.6	0.6
ROE (%)	20.3	16.5	18.7	20.0	17.8	13.1	14.0	15.1
ROA (%)	14.1	11.8	13.7	15.1	13.5	10.0	11.0	12.0
GP margin (%)	70.5	70.3	72.2	74.3	69.7	70.3	70.3	70.2
OP margin (%)	16.0	14.7	15.9	15.8	14.6	13.8	14.4	15.7
NP margin (%)	12.2	10.1	11.6	12.6	12.8	10.3	11.1	12.1
EBITDA margin (%)	20.6	19.2	20.4	19.6	17.8	17.4	18.4	19.8
ROIC (%)	25.2	21.3	24.3	25.4	18.5	14.8	16.8	19.1
WACC (%)	7.5	7.4	5.9	5.8	5.3	5.3	5.3	5.3
ROIC less WACC (%)	16.8	13.2	18.9	18.3	11.9	8.7	11.3	12.7

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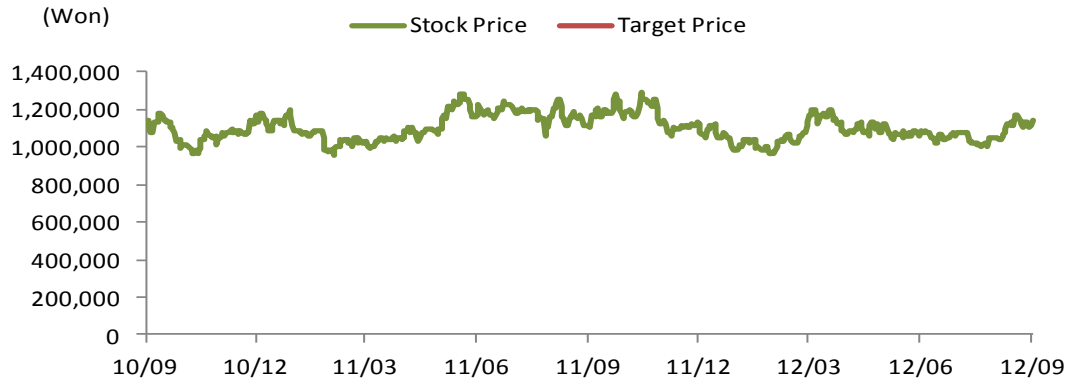
▶ Ratings and target price history in past two years

Amore Pacific (090430 KS)	
Date	2012-09-17
Rating	BUY(New)
Target Price	**1,430,000**

▶ Target price changes in past two years



▶ Investment period and ratings

Company	
BUY	The stock is expected to outperform the market by at least 15%p over the next 12 months.
HOLD	The stock is expected to either outperform or underperform the market by less than 15%p over the next 12 months.
SELL	The stock is expected to underperform the market by at least 15%p over the next 12 months

Industry	
OVERWEIGHT	Industry indicators are expected to outperform the by at least 5%p over the next 12 months.
NEUTRAL	Industry indicators are expected to be in line with the market within 5%p over the next 12 months.
UNDERWEIGHT	Industry indicators are expected to underperform the market by at least 5%p over the next 12 months

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