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 Equity – Korea

Korea Brokers: 3QFY08 results

Profitability yet to recover

- ▶ **3QFY08 results boosted by valuation gains on bond holdings and rising brokerage commission, but unlikely to be sustainable**
- ▶ **Net revenue margins (including proprietary trading) improved, especially at Mirae Asset Securities**
- ▶ **Despite exuberance over the Capital Market Consolidation Act, we don't see financial benefits near term: maintain Underweight (V) on Samsung, Neutral (V) on Mirae**

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3QFY08 earnings recovered mainly on trading income and mild increase in

brokerage commission: a sharp fall in market interest rate brought up the valuation gains on bond holdings, which helped boost earnings significantly. In addition, a mild recovery in brokerage commission also boosted net revenue. Asset management fees, however, were still on a downward trend due to equity market performance. Cost efficiency boded ill for Samsung due to the rise in marketing and salary expenses. In contrast, the flexible cost structure led Mirae Securities to contain SG&A, with a cost-to-income ratio of 54% in 3QFY08.

Exuberance over Capital Market Consolidation Act: we believe the market is too excited about the Capital Market Consolidation Act (which came into force at the start of February) as we don't see financial benefits near term. In addition, given the weakness of market trading volumes so far in 2009, it will be tough to maintain sustainable brokerage commission growth. We maintain our cautious view on the sector and daily trading value assumptions of W6.3trn in FY08e.

Maintain our forecasts, valuation and ratings: We prefer Mirae over Samsung due to higher net revenue margin (exclusive of prop trading income) and better cost control under the opaque outlook in brokerage sector. Maintain N (V) on Mirae and UW (V) on Samsung.

Korean Brokers: Valuation Overview

Company code	Company name	Target price (KRW)	Close price (KRW)	Rating	P/E (x)	P/B (x)
037620 KS	Mirae Asset Securities	73,000	74,000	Neutral (V)	21.22	1.72
016360 KS	Samsung Securities	54,000	61,600	Underweight (V)	18.73	1.73

Note: Fiscal year ends March; price as of market close, 10 Feb, 2009; Source: Company data, HSBC estimates

Table1. Earnings summary: 3QFY2008

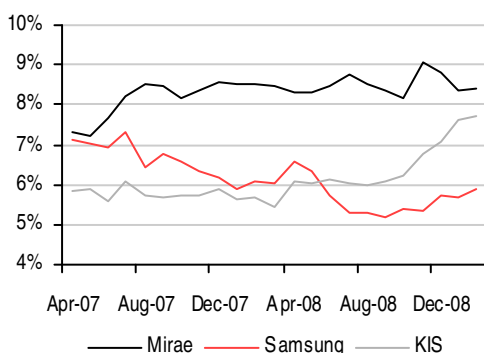
Items	Mirae Asset Securities		Samsung Securities	
	3QFY08 (Wbn)	q-o-q (%)	3QFY08 (Wbn)	q-o-q (%)
Net Revenue (Operating Profit + G&A Expense)	134	21	185	23
1) Asset management fee	32	(31)	16	(30)
2) Brokerage commission	43	6	81	16
3) Investment banking	9	19	3	(81)
4) Net Interest profit & other	41	(3)	71	(5)
5) Trading Income & Principal Investments	18	n/a	15	n/a
SG & A	(72)	(11)	(142)	24
Operating profit	62	110	41	41
Non-operating profit	(6)	8	5	(54)
Net income before tax	56	135	46	16
Net income	42	140	34	13
Cost/ Income (%)	54%	-20ppt	78%	-2ppt
Net revenue margin (%)	54%	31ppt	33.5	8ppt

Source: Company data, HSBC

Profits recovered by bond holding gains but business outlook remains opaque in our view

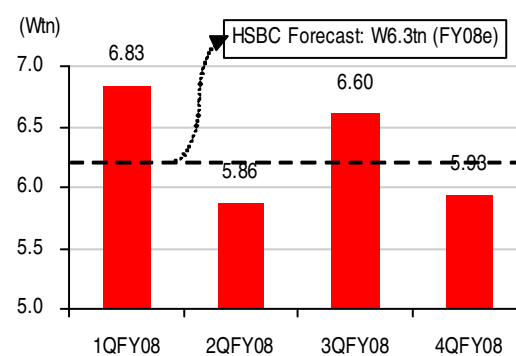
- Recovering brokerage commissions:** Both Samsung and Mirae Asset Securities showed brokerage commission growth on the back of higher market trading volume in F3QFY08. Market daily trading value has increased from W5.8trn in 2QFY08 to W6.6trn in 3QFY08. Samsung gained the commission market share by 0.3ppt to 5.8% and Mirae by 0.15ppt to 8.7% both on a volume basis. Entering in January-09, the market trading value has declined to W5.9trn on average, therefore, this double digit commission growth is hard to be maintained. We keep our assumption of daily trading value of W6.3trn for FY2008e unchanged (Chart2)
- A continuous downtrend in asset management fees:** Given the weak equity market performance, the equity related fund sales balance has been shrunk by large. On top of this, high-fee-generating funds growth such as hybrid or derivatives linked funds also diminished in 3QFY08. As consequence, a fall in asset management fees on both companies continued in 3QFY08, down by around 30% qoq for both.

Chart1. Brokerage commission market share on Korean brokers under HSBC coverage universe



Source: KOSCOM, HSBC

Chart2. Daily trading value on KOSPI + KOSDAQ



Source: QuantWise, HSBC

- ▶ **Trading gains, boosted by valuation gains on bond holdings:** Following the big losses on valuation losses on bond holdings, 3QFY08 showed equivalent size of valuation gains on back of falling market rates. We, however, consider this as a low quality of earnings due to high volatility depending on market rate and prop trading performance, therefore, when we calculate the net revenue margin, we stripped out these prop trading profits.
- ▶ **Cost efficiency:** Mirae Asset Securities has well managed its SG&A with cost-to-income ratio of 58% vs. 70% in Samsung Securities on an accumulated basis till 3QFY08. Mirae has more flexible cost structure with salary consisting of 62% of G&A and fixed expenses of 11%. Samsung Securities, however, showed much rigid cost structure with salary of 56% of G&A and fixed expenses of 22% on an accumulated basis. Additionally, Samsung Securities has spent greater marketing costs in 3QFY08, up by 134% qoq.

Profitability far from a recovery

As we have argued since our initiation on Korean brokers, we try to eliminate the earnings volatility from proprietary trading due to the characteristics (hard to be projected and also not sustainable). Therefore, we created the new profitability measures as net revenue margin, defined as net revenue exclusive of prop earnings divided by operating profits. Looking at Chart 3 below, quarterly net revenue margins are sharply rising at Mirae compared to sluggish up-tick in Samsung. We believe this trend will persist going forward due to cost efficiency at Mirae Asset Securities (Chart4)

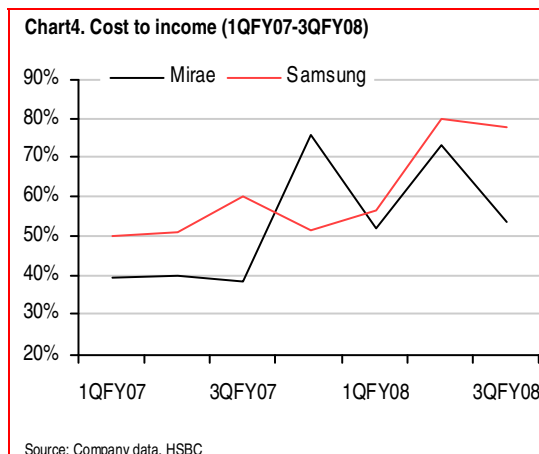
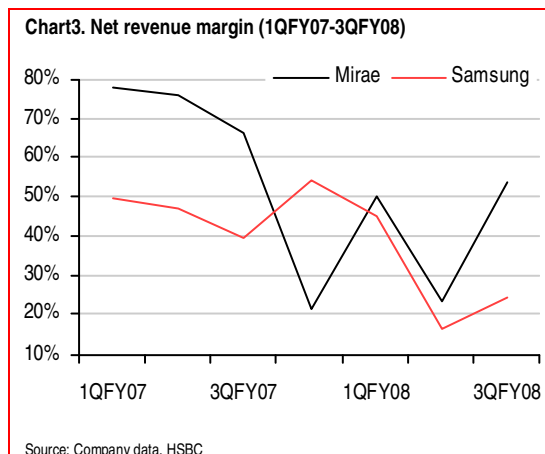
Valuation and risks

We maintain our valuation methods, earnings and ratings on Mirae Asset Securities and Samsung Securities. We value Mirae Asset Securities on price-to-book basis and Samsung Securities on a sum of the parts basis, separating the brokerage and asset management businesses. Our valuation assumptions are tabulated below.

Key risks on the stock

Market upside risks: as a high beta play, securities companies carry market risks as brokerage commissions are still a major source of income.

Regulation risks: securities companies may be affected sudden regulation changes.



Mirae Asset Securities:

- ▶ Litigation risk: a group of investors is preparing to launch legal action against fund sellers and the asset management company for 'Insight' Fund, and Mirae sold a large portion of the Fund.
- ▶ The sudden collapse of one of Mirae's PF (Project Financing) or PI (Principal Investment) related loans could lead to a large provisioning charge against its future earnings
- ▶ Market share gains in brokering, especially institutional trading, ie if Mirae Asset Global Investment increases trading with Mirae Asset Securities, would raise its brokerage commission.

Samsung Securities:

- ▶ Samsung group risks: Samsung Securities is part of the Samsung family of financial companies (Samsung Life, Samsung Card, Samsung ITC and Samsung F&M etc). Any big change in the group may affect the business of Samsung Securities. If Samsung ITC better performs, Samsung Securities will be a major beneficiary.

Table2. Valuation method: Miare Asset and Samsung securities

	Mirae	Samsung
Valuation methodology	Price-to-book basis	Sum of the parts
Broker business		
Sustainable ROE	15.0%	15.0%
Cost of Equity	11.6%	12.1%
Risk free rate	5.0%	5.0%
Beta	1.2	1.14
Risk premium	5.5%	5.5%
Terminal growth	7.0%	3.0%
Book value (FY08e)	1,680	2,382
Target P/B (x)	1.74	1.32
Implied market cap for brokerage	2,922	3,422
Asset management business		
Target P/E (x)		9
Value to parent (Wbn)		179
Fair Value (Wbn)	2,922	3,636
Target Price (KRW)	73,000	54,000

Source: HSBC estimates

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Share price and rating changes for long-term investment opportunities

Samsung Securities Co Ltd (016360.KS) Share Price performance KRW Vs

HSBC rating history



Source: HSBC

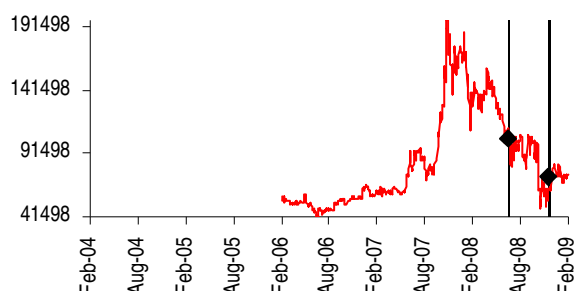
Recommendation & price target history

From	To	Date
N/A	Overweight	25 June 2008
Overweight	Underweight (V)	11 November 2008
Target Price	Value	Date
Price 1	82000.00	25 June 2008
Price 2	54000.00	11 November 2008

Source: HSBC

Mirae Asset Securities Co (037620.KS) Share Price performance KRW Vs

HSBC rating history



Source: HSBC

Recommendation & price target history

From	To	Date
N/A	Underweight	25 June 2008
Underweight	Neutral (V)	27 November 2008
Target Price	Value	Date
Price 1	103300.00	25 June 2008
Price 2	73000.00	27 November 2008

Source: HSBC

HSBC & Analyst disclosures

Disclosure checklist

Company	Ticker	Recent price	Price Date	Disclosure
MIRAE ASSET SECURITIES CO	037620.KS	74300.00	09-Feb-2009	2
SAMSUNG SECURITIES CO LTD	016360.KS	61500.00	09-Feb-2009	6, 7

Source: HSBC

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