

At the center of changes

Scenarios circulating in the market

In regard to recent events such as Samsung Everland's (Everland) takeover of Cheil Industries' (Cheil) fashion business and the announced merger of Samsung SDS (SDS) and Samsung SNS, investor interest is on the group-wide governance, succession plans and the consequences for stock prices. It is difficult to say which step is next for the Samsung Group. At this point, we believe it practical to look at possible scenarios and predict impacts based on what the market expects.

Market scenario 1: Switch to holding company structure

Some investors expect to see fundamental changes to the group-wide governance, such as switching to a holding company structure. The transition can be a mid to long-term possibility but seems unlikely in the near-term. First, the need to switch is not big from both legal and economic aspects. Even if Everland becomes the largest shareholder of Samsung Life Insurance (Samsung Life), the likelihood of Everland becoming the holding company now looks slim given that its stake in the insurer is worth less than 50% of its assets. Second, drawbacks from the transition can outweigh benefits. Affiliates, spread across finance and industrial sectors, would have to spend a lot to buy stakes and on taxes in the process of ending circular shareholding. Furthermore, buying affiliate stakes as treasury shares, as proposed by some investors, is not allowed by the current rules. Meanwhile, the need for stronger managerial rights, one of the key advantages of a holding company, is not significant at Samsung Group given the fairly stable management.

Market scenario 2: Succession plan maintaining current group-wide governance

Barring the assumption of a holding company transition, the Samsung Group may follow a succession plan via a co-governance system or affiliate separation by dividing each business among Chairman Lee Kun-hee's children.

1) Co-governance system

The Samsung Group may adopt a succession plan while maintaining the current group-wide governance that flows from "major shareholders → Everland → Samsung Life → Samsung Electronics". That is, corporate governance restructuring would be unnecessary for the succession plan to proceed. For example, with major shareholders having joint control of Everland that acts as a holding company (similar to other major conglomerates such as LG, GS and Doosan), a responsible business conduct would be adopted for each affiliate. In this case, the succession plan would have a limited effect on individual companies.

2) Subsidiary/division grouping

Another scenario is handing over a group of divisions to each child while the group-wide governance remains intact. At present, the market speculates subsidiaries/divisions would be grouped as electronics and finance, domestic demand-driven (e.g., construction and hotels) and services (e.g., fashion and ads). Realistically, it is impossible to predict which businesses/companies would be reshuffled. Still, SDS and Everland will very likely go public to secure required stakes and support fair share prices as the children's shares are concentrated at the two firms. In that case, we must focus on companies with stakes in the above firms such as Samsung C&T (equity value compared to market cap 11%), Samsung Electro-Mechanics (SEMCO, 11%) and KCC (21%).

A series of events at Samsung Group

In September, the market witnessed a series of Samsung Group-related events such as Everland's takeover of Cheil's fashion business, Samsung C&T adding to its stake in Samsung Engineering and an announced merger of SDS and Samsung SNS. Now investor interest is on the group-wide governance, succession plans and the consequences for stock prices. It is difficult to say which step is next for Samsung. At this point, we believe it practical to look at possible scenarios and predict the impact on related shares based on what the market expects.

Table 1. Changes to Samsung affiliate shareholdings

Affiliates	Note
Cheil Industries	On September 23 decided to sell the fashion business to Everland for W1.05tn
Samsung C&T	Expanded ownership of Samsung Engineering to 1.82% in September following acquisition of 0.6% stake in August
Samsung SDS	On September 27 decided a 1:0.46 merger with Samsung SNS

Source: FSS, Seoul Economic Daily

Market scenario 1: Switch to a holding company structure

Looking at the active business restructuring among Samsung Group affiliates, more investors increasingly expect fundamental changes to the group-wide governance, such as switching to a holding company structure. Although the transition can be a mid to long-term possibility, it seems unlikely in the near-term.

First, the need to switch is not big from both legal and economic aspects. So far, the possibility existed that Everland, with its stake value in Samsung Life exceeding 50% of its total assets (as of 1H13), could become the holding company if it claims the largest shareholder spot at the insurer. But the possibility now looks slim as Everland's stake in Samsung Life (W4.1tn at the October 1 closing price of W105,000) is worth less than 50% of total assets (W8.4tn at end-2013F). Also, given the room for business expansion in future, the prospects seem dim for Everland to become the holding company.

Table 2. Everland's Samsung Life stake value vs. own assets value

	1H13	End-2013F
Total assets	7,335	8,385
Samsung Life stake value	4,178	4,062
Ratio	57.3	48.4

Note: 1) K-IFRS (separate) accounting; 2) The acquisition of Cheil's fashion business is considered for end-2013F figures; 3) Stake value for Samsung Life at the October 1 closing price of W105,000

Source: Korea Investment & Securities

Second, drawbacks from the transition can outweigh benefits. To switch to a holding company, Samsung Group must end cross-ownership between financial (Samsung Life) and industrial (Samsung Electronics) affiliates to stay on the right side of the law, such as the Act on the Structural Improvement of the Financial Industry and the Financial Holding Companies Act. The task would be daunting as affiliates would have to spend a lot to buy stakes and on taxes in the process of ending the circular shareholding and rearranging ownership between affiliates.

Of note, buying affiliate stakes as treasury shares, as proposed by some investors, is not allowed in the current share buyback rules. Moreover, equity swaps between affiliates (not buying newly issued shares via investment in kind) are subject to corporate taxes.

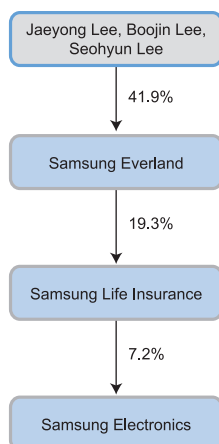
Meanwhile, the need for stronger managerial rights, one of the key advantages of a holding company, is not significant at Samsung Group given the fairly stable management at present.

Market scenario 2: Succession plan maintaining current governance

Barring the assumption of a holding company transition, the Samsung Group may follow a succession plan via a co-governance system or affiliate separation by dividing each business among Chairman Lee's children.

1) Group management via co-governance system
There is a chance that Samsung Group will adopt a succession plan while maintaining the current group-wide governance that flows from "major shareholders → Everland → Samsung Life → Samsung Electronics". That is, a corporate governance rebuild would be unnecessary for the succession plan to proceed. Moreover, the co-governance system would be a way to maintain the current group-wide governance with major shareholders having joint control of Everland that in practicality performs the role of a holding company.

Figure 1. Group-wide governance structure



Source: Korea Investment & Securities

For other major conglomerates such as LG, GS and Doosan, their major shareholders jointly own stakes in the holding company. In the case of the GS Group, more than 50 special-interest parties own 46% of GS Holdings. At present, Chairman Huh Chang-soo runs GS Holdings, Chairman Huh Dong-soo GS Caltex and President Huh Tae-su GS Home Shopping.

Also for the Samsung Group, while Chairman Lee's children have joint control of Everland that acts as a holding company, a responsible business conduct would be adopted for each affiliate. In this case, the succession plan would have a limited effect on individual companies as there would be no significant stake disposal for each business while the current group-wide governance is maintained.

2) Affiliate grouping via business separation

Another scenario is handing over a group of divisions to each child while the group-wide governance remains intact. At present, the market speculates subsidiaries/divisions would be grouped as electronics and finance, domestic demand-driven (e.g., construction and hotels) and services (e.g., fashion and ads).

Realistically, it is impossible to predict which businesses/companies would be reshuffled. Still, SDS and Everland will very likely go public to secure the required stakes and support fair share prices as the children's shares are concentrated at the two firms. In that case, we must focus on companies with stakes in the above firms such as Samsung C&T, SEMCO and KCC.

Analysis of Everland value

Everland's value can be largely divided between operating value, securities and land. When Samsung

Card sold its stake in Everland to KCC and when Everland purchased treasury shares, the share price was W1.8mn and EV stood at W4.6tn. We estimate current EV at W7.0tn based on its stake in Samsung Life (W105,000 per share), land (W300,000 per 3.3m²) and EBITDA 7.0x for operating value. Applying a 0-30% discount for investment assets, the firm's market value is pegged at W5.5tn-7.0tn.

Table 3. Samsung Everland valuation

Investment assets (W bn)	Based on current price	4,874
Operating value (W bn)	Based on EV/EBITDA 7.0x	1,673
Land value (W bn)	Assuming W300,000 per 3.3m ²	1,309
Net debt (W bn)	As of end-2012	849
NAV (W bn)		7,007
Shares		2,500,000
Estimated market value		
1. Fair NAV (W bn)	0% discount on securities	7,007
	Per share NAV (KRW)	2,802,779
2. Fair NAV (W bn)	20% discount on securities	6,032
	Per share NAV (KRW)	2,412,869
3. Fair NAV (W bn)	30% discount on securities	5,545
	Per share NAV (KRW)	2,217,914

Source: Korea Investment & Securities

Table 4. Samsung Everland financial summary (W bn, %)

Income statement	2011A	2012A	2013.1H
Sales	2,687	3,001	1,530
OP	221	134	65
NP	151	297	57
Assets	5,914	6,659	7,291
Liabilities	2,135	2,839	2,837
Shareholders' equity	3,779	3,820	3,805
Net debt	(121)	878	875

Note: K-IFRS (consolidated)
Source: Korea Investment & Securities

Analysis of SDS value

For the merger of SDS and Samsung SNS, announced on September 27, their shares were priced as W75,220 and W34,789, respectively. Based on that, SDS' post-merger value is estimated at W5.8tn.

Table 5. Valuations of SDS and SNS for the merger

	Samsung SDS	Samsung SNS
Price per share (KRW)	75,220	34,789
Shares	72,256,772	11,089,000
Value (W bn)	5,435.2	385.8
Post-merger value	5,821.0	

Source: Korea Investment & Securities

Table 6. SDS financial summary (W bn, %)

Income statement	2011A	2012A	2013.1H
Sales	4,765	6,106	2,673
OP	414	558	234
NP of controlling interest	327	396	147

Note: K-IFRS (consolidated)
Source: Korea Investment & Securities

Table 7. SNS financial summary

(W bn, %)

Income statement	2011A	2012A	2013.1H
Sales	500	512	232
OP	22	54	21
NP of controlling interest	15	37	16

Note: K-IFRS (consolidated)
Source: Korea Investment & Securities

Samsung affiliates with Everland and SDS holdings

If Everland and SDS go public, the shareholders will see their enterprise value appreciate thanks to the rising value of investment securities. Some companies may enjoy cash inflow from the stake sale.

We assume the value of Everland at W6.0tn and SDS W5.8tn. From those assumptions, Everland and SDS' stake value as a percentage of market capitalization is the largest for Samsung C&T (11%), followed by SEMCO (11%) and Cheil (5%). Of note, their holdings of Everland and SDS would very likely be liquidated via sale after possible share floatation as the stakes are not crucial to maintain managerial rights at each company. As such, the equity holdings value of each company deserves close monitoring. KCC, a non-Samsung affiliate, also deserves attention given its 17% ownership of Everland that equals 21% of its own market capitalization.

Table 8. Major affiliates' ownership of Everland and SDS

	Combine d stake value (W bn)	Mkt. cap (W bn)	% of mkt. cap.	Everland		SDS	
				Value (W bn)	Ownership (%)	Value (W bn)	Ownership (%)
1. Group affiliates	4,644			1,722	29.6%	2,631	45.2%
Samsung C&T	1,178	10,168	11%	86	1.5%	994	17.1%
SEMCO	233	6,475	11%	233	4.0%	459	7.9%
Cheil	1,080	4,819	5%	233	4.0%		
Samsung SDI	692	8,752	3%	233	4.0%		
Samsung Elec.	233	223,364	1%			1,178	20.2%
Everland	887			887	15.2%		
Others	51			51	0.9%		
2. Major shareholders	3,789			2,680	46.0%	1,109	19.1%

Note: SDS shares reflect a post-merger effect
Source: FSS, Korea Investment & Securities

Table 9. Samsung Group in-house shares

	Everland		SDS		Samsung Life		Samsung Electronics		Samsung C&T		Hotel Shilla		Cheil	
	Shares ('000)	Stake (%)	Shares ('000)	Stake (%)	Shares ('000)	Stake (%)	Shares ('000)	Stake (%)	Shares ('000)	Stake (%)	Shares ('000)	Stake (%)	Shares ('000)	Stake (%)
In-house shares (1+2+3)	2,016	80.7	49,754	64.3	102,230	51.1	42,450	28.8	31,162	19.6	7,261	18.5	5,573	10.6
1. Chairman & family	1,151	46.1	14,755	19.1	41,519	20.8	6,909	4.7	2,206	1.4	0	0.0	0	0.0
Lee Kun-hee	93	3.7	10	0.0	41,519	20.8	4,985	3.4	2,206	1.4				
Lee Jaeyong	627	25.1	8,707	11.3			840	0.6						
Lee Boojin	209	8.4	3,019	3.9										
Lee Seohyun	209	8.4	3,019	3.9										
Other special-interest parties	12	0.5					1,083	0.7						
2. Subsidiary	484	19.4	34,972	45.2	60,709	30.3	19,120	13.1	19,932	12.5	6,624	16.8	3,746	7.1
Samsung Elec.			15,656	20.2							2,005	5.1		
Cheil	125	5.0									525	1.3	2,450	4.7
Samsung C&T	100	4.0												
Samsung E&M	37	1.5	13,216	17.1			5,976	4.1						
Samsung SDI	100	4.0	6,100	7.9	1,206	0.6								
Samsung F&C	100	4.0							11,548	7.2	29	0.0		
Samsung Securities	22	0.9			9,360	4.7	38	0.0	123	0.1			905	1.6
Samsung Life											1,200	3.1		
Samsung F&M							11,143	7.6	7,475	4.7	2,865	7.3	7	0.0
Everland							1,857	1.3						
Samsung Life Public Welfare Foundation					38,688	19.3								
Other special-interest parties					9,360	4.7								
3. Treasury shares					2,095	1.0	106	0.1	786	0.5			384	0.8

Note: SDS shares reflect a post-merger effect
Source: FSS, Korea Investment & Securities

The contents of this report accurately reflect the analyst's views. Under no circumstances were there any external pressures or intervention during the analysis process or the preparation of this report.

This report was written by Korea Investment & Securities Co., Ltd. to help its clients invest in securities. This material is copyrighted and may not be copied, redistributed, forwarded or altered in any way without the consent of Korea Investment & Securities Co., Ltd. This report has been prepared by Korea Investment & Securities Co., Ltd. and is provided for information purposes only. Under no circumstances is it to be used or considered as an offer to sell, or a solicitation of any offer to buy. We make no representation as to its accuracy or completeness and it should not be relied upon as such. The company accepts no liability whatsoever for any direct or consequential loss arising from any use of this report or its contents. The final investment decision is based on the client's judgment, and this report cannot be used as evidence in any legal dispute related to investment decisions.

HEAD OFFICE

CHUN SOO LIM, Executive Vice President, Head of Global Institutional Group (cslim@truefriend.com +822 3276 5800)
PAUL CHUNG, Sales Trading (pchung@truefriend.com +822 3276 5843)
27-1 Yoido-dong, Youngdeungpo-ku, Seoul 150-745, Korea
Toll free: US 1 866 258 2552 HK 800 964 464 SG 800 8211 320
Fax: 822 3276 5681~3
Telex: K2296

NEW YORK

DONG KIM, Managing Director (dkim@kisamerica.com +1 212 314 0681)
HOON SULL, Head of Sales (hoonsull@kisamerica.com +1 212 314 0686)
Korea Investment & Securities America, Inc.
1350 Avenue of the Americas, Suite 1110
New York, NY 10019
Fax: 1 201 592 1409

HONG KONG

DANIEL KIM, Managing Director, Head of HK Sales (daniel.kim@kisasia.com +852 2530 8950)
DAN SONG, Sales (dan.song@kisasia.com, +822-3276-5621)
JUN HWAN KIM, Sales (jun.kim@kisasia.com, +852-2530-8912)
Korea Investment & Securities Asia, Ltd.
Suite 2201-2, Jardine House
1 Connaught Place, Central, Hong Kong
Fax: 852-2530-1516

SINGAPORE

SUNG NAMGOONG, Managing Director, Head of Singapore Sales (snamgoong@truefriend.com +65 6501 5601)
ALEX JUN, Sales (alex.jun@truefriend.com +65 6501 5602)
Korea Investment & Securities Singapore Pte Ltd
1 Raffles Place, #43-04, One Raffles Place
Singapore 048616
Fax: 65 6501 5617

LONDON

JJ MOON, Managing Director (jamesmoon@kiseurope.com +44 207 065 2765)
MINGOO KANG, Sales (mingookang@kiseurope.com, +44 207 065 2760)
Korea Investment & Securities Europe, Ltd.
2nd Floor, 35-39 Moorgate
London EC2R 6AR
Fax: 44-207-236-4811
Telex: 8812237

This report has been prepared by Korea Investment & Securities Co., Ltd. and is provided for information purposes only. Under no circumstances is it to be used or considered as an offer to sell, or a solicitation of any offer to buy. While all reasonable care has been taken to ensure that the information contained herein is not untrue or misleading at the time of publication, we make no representation as to its accuracy or completeness and it should not be relied upon as such. This report is provided solely for the information of professional investors who are expected to make their own investment decisions without undue reliance on this report and the company accepts no liability whatsoever for any direct or consequential loss arising from any use of this report or its contents. This report is not intended for the use of private investors.

2013. All rights reserved. No part of this report may be reproduced or distributed in any manner without permission of Korea Investment & Securities Co., Ltd.