MIRAE ASSET
LENS

Q2 2014

# Rise of New Korea

For long, equity markets have been enamored by the Korean prowess in the traditional industries like industrials and shipbuilders, tending and tend to gravitate towards them as the sentiment on Korea turns positive.

What's happening in the background is a more powerful trend, the rise of the soft power of Korea through popular dramas and music videos such as Gangnam style. Unlike some trends with limited shelf life, the sheer influence of Korean culture & brands on the Asian Psyche has been strengthening over the last couple of years.

New heights have been achieved by a Korean soap opera called "My Love from the Star"- a story of an alien who landed on Earth 400 years ago, who then falls in love with a top actress in the modern era, had a viewing rate of 24% in Korea and was viewed an astounding 2.5 billion times in China, reaching the top of the charts and sparking yet another debate on why local Chinese media is unable to produce such blockbusters. The show's popularity has been so high that the consumers are flocking to whatever product, clothes, cosmetics, or snacks lead actress Jun Ji-hyun uses in the show. We believe such a trend will continue to benefit Korean brands to prosper in Asia in the foreseeable future.

From a portfolio perspective, we are looking to capitalize on this opportunity through companies in the cosmetics and snacking segments, travel and tourism segments, and social networking services with a large following in Asia.

## Cosmetics & Snacks

"The proof is in the pudding". We were impressed with Korean cosmetic brands in China when we visited cosmetic companies in Shanghai, including Shiseido and Shanghai Jiahwa. Both Japanese and Chinese CEOs highly valued and appreciated Korean brands. The Korean wave is undoubtedly acting as a big tailwind. Moreover, Korean brands have been innovative by creating new skin care categories such as BB(Blemish Balm) cream and CC(Color Control) cream. Amorepacific caters to high-end consumer demand through Sulwhasoo, a traditional oriental medicine based brand, and a key growth driver at duty free store sales in Korea. More importantly, the company focuses on mass market consumers with four brands, namely Laneige, Mamonde, Innisfree, and Etude. Innisfree entered China in 2013 and thanks to robust sales growth, has already achieved break even.

In contrast, we have been hearing of L'Oreal de-emphasizing Garnier in China and Revlon exiting the country. Outwitted and outgunned by big promotional spending, Asian brands including the Korean brands have struggled in the luxury cosmetics against their Western peers like Estee Lauder and L'Oreal. On the other hand, Korean companies have a

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Building on principles

competitive edge in the mass market segment, as brand shops will work perfectly well for mass market brands. Like fast fashion retailers Zara and Uniqlo, Korean cosmetics specialty stores that sell only their own products will enable brands to come to market faster, have direct feedback and better understand customers. This business model will become a huge competitive advantage for Korean brands versus global brands, which mostly rely on the wholesale model.

Typical Etude store


Innisfree store in Hong Kong

Further evidence of "Regionally Scalable Consumer Company" is Korean Choco Pie maker Orion, which, since starting in Korea in the 1990s, successfully branched out to China in the last decade. China sales for Orion have compounded at more than 35% per year for the last 5 years and now account for more half of group sales and nearly 65% of profits.

In recent times, Orion has suffered from the overall weakness in China consumption in 2013. However, we believe Orion's fundamentals and competitiveness remain intact, thus capturing additional market share. In 2014, the company will further expand its distribution network into traditional trade which will reduce reliance on modern trade. Currently, traditional trade accounts for 30% of Orion's China sales and this will increase to 35% in 2014 and 40-45% in 2015. In addition, the company plans to launch more new products in the coming years, leveraging the larger product range already sold in Korea. Further, Orion is seeding new frontiers of growth for the next decade with a presence in Russia, Vietnam, and India. We were pleasantly surprised to see Orion at the entrance of a Reliance Hypermarket in a suburban mall in Mumbai.


Orion Choco Pie at Reliance Hypermarket, Phoenix Kurla, Mumbai

## Travel & Tourism

A part of the New Korea theme is the sheer attractiveness of the country as a tourist destination primarily for the Chinese. Realizing the potential of tourism led service sector growth, President Park has highlighted the sector as the next big economic growth driver.

Outbound tourists from China have increased nearly threefold over the last decade to nearly 100 million in 2013. However, despite the impressive growth, outbound-travel penetration in China is still low at 6%, compared with 15% in Japan, 28% in Korea, and 45% in Taiwan. We expect the number of outbound tourists to continue to grow strongly thanks to a rising middle class and increasing spending on such experiences. Chinese tourists to Korea were 4.3 million in 2013, up more than five fold over the last 8 years.

Korea has emerged as one of the most desired travel destinations among Chinese thanks to the K-culture wave and popular Korean products, such as cosmetics and apparel. According to the Korean Tourism Organization, shopping has taken over natural sightseeing as the biggest driver of tourism since 2009. Hotel Shilla is a direct beneficiary of fast growing Chinese inbound tourists to Korea as it has a 35% market share in Korea's duty free market. Chinese customers accounted for 48% of revenue in 2013, up from only 16% in 2010. Per person spending also increased by more than 30% in the same period. Hotel Shilla will expand the Jeju duty free shop by 70% at the end of 2014 and is looking to sign additional duty free store contracts outside of Korea. Hotel Shilla also plans to roll out 4 star business hotel chains, called 'Shilla Stay' on a management contract basis and aims to open 20 business hotels nationwide by 2017.


High traffic at 6 AM on a Sunday at DFS of Korea Incheon international airport

## Social Networking & Mobile Platform

The third pillar of our New Korea story is its Social Networking Service & Mobile Platform. This is exemplified by "LINE" from Naver, which started as a messenger app and has evolved into a mobile platform, allowing businesses of all sizes to transcend distribution barriers and engage with the relevant audience in a cost effective way.

The amazing part of the story is that LINE's key countries of strength, namely Japan, Taiwan and Thailand are all outside its home market of Korea. With about 380 million subscribers currently, and adding 800-900,000 a day, LINE has 50 million subscribers in Japan, 22 million in Thailand and 17 million in Taiwan.

Admired as "the company to work for" by the young technical graduates in Korea, LINE's campus outside of Seoul more closely resembles a Silicon Valley workplace than a traditional Korean company. Their huge library has a wide array of books on design and programming, two prerequisites for a successful technology company.

Naver, Corporate HQ


Bollywood actress Katrina Kaif endorsing LINE

A perfect example of their "Think Global, Act Local" mantra is the company's approach in India, a market where it has Bollywood youth icon Katrina Kaif endorsing the service, generating over 17 million subscribers in relatively short period of time.

Moving beyond the traditional gaming revenues, LINE is looking to monetize its mobile platform by offering services such as "Official Accounts", an effective tool for brands for customer retention and information delivery on new items and promotions. The value proposition of LINE over other social networks and other means of advertising are its accuracy and depth of reach.

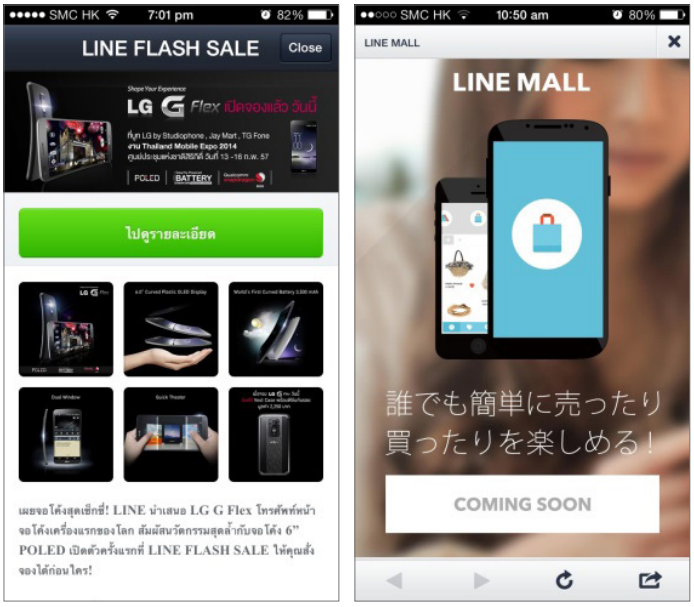
LINE is ranked highly in terms of revenue (excluding games) in 2013 by AppAnnie, indicating the platform's ability to monetize its user base. We believe that the coming quarters will see a strong continuation of this trend as the company scales up its non-gaming revenue through LINE Mall, Flash sale, and 20,000+ Line @ accounts for SMEs.

Total 10 : Top Pubilshers Of 2013 :
Worldwide iOS & Google Play Game Revenue

| Rank 2013 | Game Publisher | Headquarters |
|---|---|---|
| 1 | Gungho Online | Japan |
| 2 | Supercell | Finland |
| 3 | King | United Kingdom |
| 4 | Electronic Arts | United States |
| 5 | **LINE** | **Japan** |
| 6 | GREE | Japan |
| 7 | CJ group | south korea |
| 8 | DeNA | japan |
| 9 | Kabam | United States |
| 10 | Gameloft | France |

Total 12 : Top Pubilshers Of 2013 :
Worldwide iOS & Google Play Revenue Of Game

| Rank 2013 | App Publisher | Headquarters |
|---|---|---|
| 1 | **LINE** | **Japan** |
| 2 | Pandara Media | United States |
| 3 | Apple | United States |
| 4 | Disney | United States |
| 5 | Comixology | United States |
| 6 | Tomtom | Netherlands |
| 7 | Zoosk | United States |
| 8 | Time Wamer | United States |
| 9 | Badoo | United Kingdom |
| 10 | Garmin | United States |



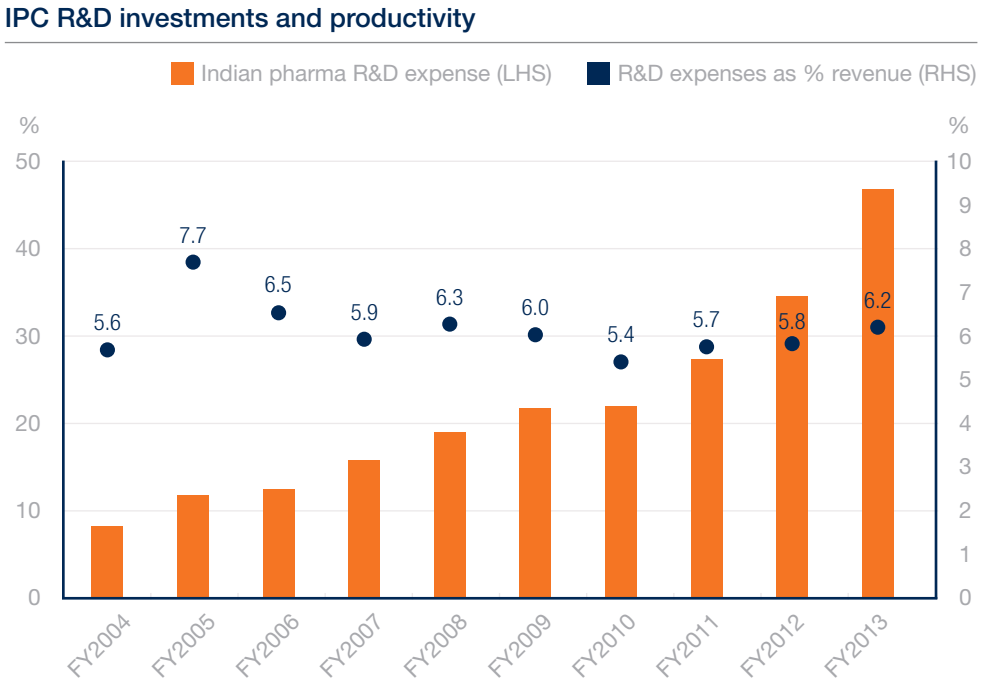

LINE Flash in Thailand/LINE MALL coming soon in Japan

# Indian Pharmaceutical Industry - Growing Up Fast

India has had a vibrant domestic pharmaceutical industry for many decades, as national laws allowed companies to develop and patent medicines that were already patented abroad. For the most part, the companies that are the largest companies in India today, focused more on simple medications, such as antibiotics and active pharmaceutical ingredients (known as API, which is what makes the drug effective). It wasn't until the late 1990s when a few Indian companies began to ramp up their US Drug Master Files (DMFs – the filing needed to make API for the US market) and Abbreviated New Drug Applications (ANDAs—the filing needed to sell a generic drug on the US market).

The last decade was characterized by perceived challenges that were overcome by the Indian pharmaceutical industry, namely the enforcement of global patents starting from 2005 as India joined the WTO, and the fear that Chinese companies would overtake the Indian companies as China was a cheaper place to manufacture. The enforcement of the patent regime turned out to be a non-event, as the Indian companies had already made significant advancements in developing their own formulation technology and had many years of experience in working around patents and challenging patents in US courts. Indian companies have been disciplined investors into their own businesses, especially in terms of R&D. In the chart below, we can see how R&D as a percentage of sales has remained steady, which means that total R&D spend has been increasing at a compound annual growth rate of 20% over the last 9 years.

## Indian Pharmaceutical Company Aggregate R&D Spending

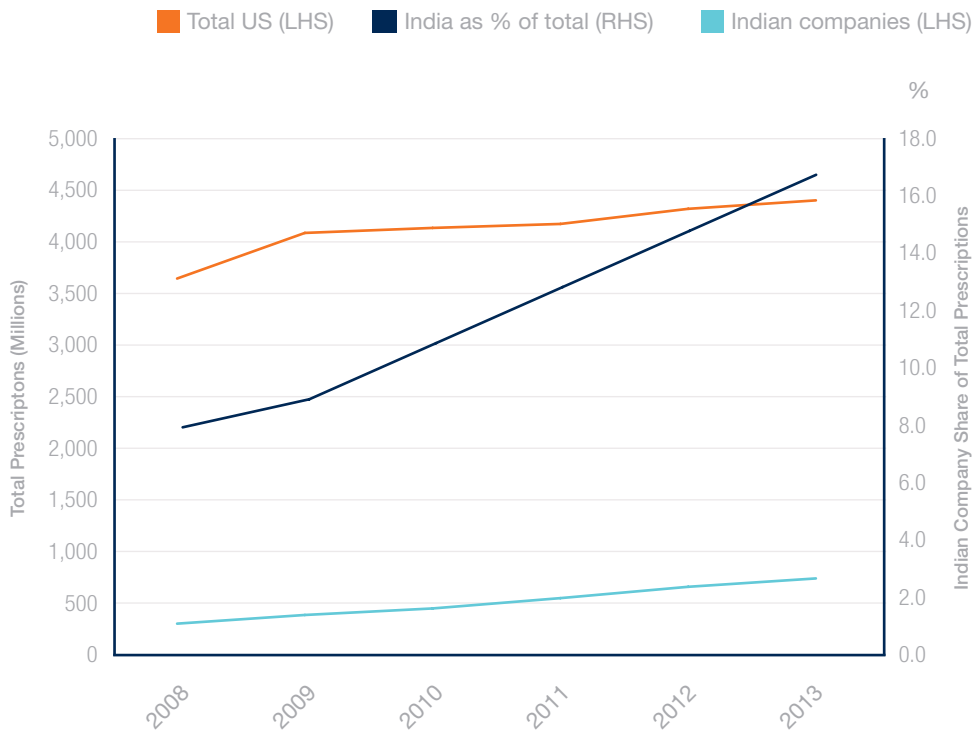



Source: IMS Health, Standard Chartered

Ironically, the threat from China actually became more of a benefit. Much of the very upstream pharmaceutical manufacturing, namely the intermediate ingredients that go into making the APIs, did move to China. It's well known now across sectors in China that manufacturing of chemical and commodity products suffers from overcapacity, but it has been in this state for many years for pharmaceutical intermediates. Thus, as this industry developed in China, Indian pharmaceutical companies were able to save costs in making their API and finished formulations. Though there are many ANDA filings in the US from Chinese companies, the volume sold is minimal. The reason is that Chinese companies are filing ANDAs in the US for the sole purpose of gaining approval and passing US FDA inspections. This enables them to go to the Chinese FDA and NDRC and get premium prices for their products, which are far higher than if they were to sell those products in the US market. This system is keeping the Chinese companies at bay.

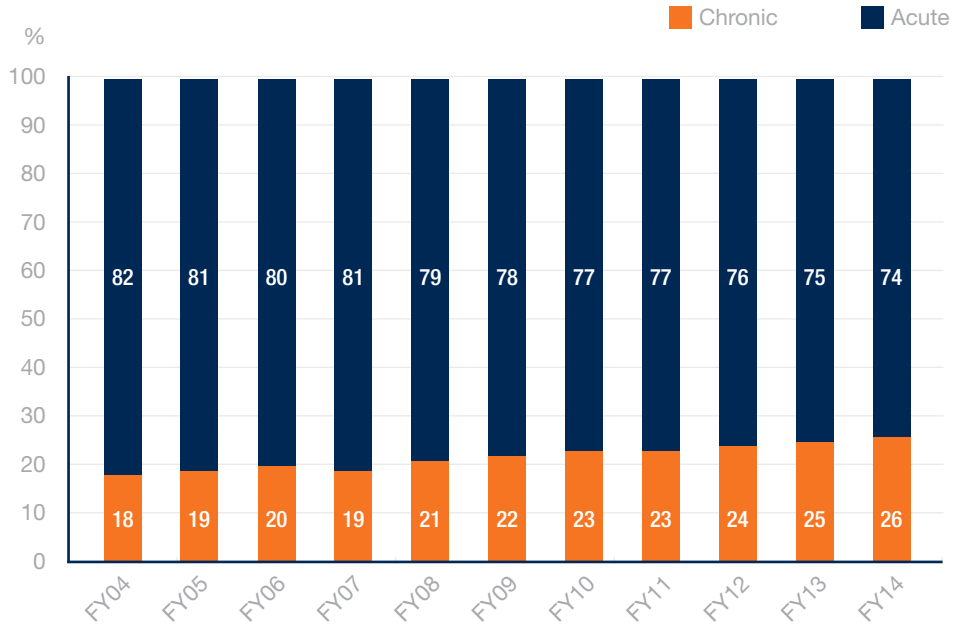
In 2000, only 5 of the 126 US ANDA approvals (4%) were from Indian companies (namely Dr. Reddy's and Ranbaxy), and three of the five were antibiotics. In 2013, 167 of the 399 ANDA approvals (42%) were from Indian companies, and this includes many companies and a wide variety of products. From the chart below, we can also see that the share of total prescriptions in the US from Indian companies is increasing rapidly, though still lagging behind the percentage of ANDA approvals. This had led to what we see here, which is an increasingly greater share of the total prescriptions filled in the US coming from Indian companies.

## US Total Precriptions



As the US ANDAs from the Indian companies evolved from antibiotics into solid oral formulations and now into more complex molecules and dosage forms, we can see that this development is also evident in their home market. From the table below, we can see that 10 years ago, the Indian pharmaceutical market was 82% acute treatments, such as antibiotics, but this has slowly declined to 74% in the most recent year, as companies have moved up the value chain and India has grown in wealth and chronic illnesses have become more prevalent. This has benefitted the industry as chronic therapies provide stable, higher margin growth.

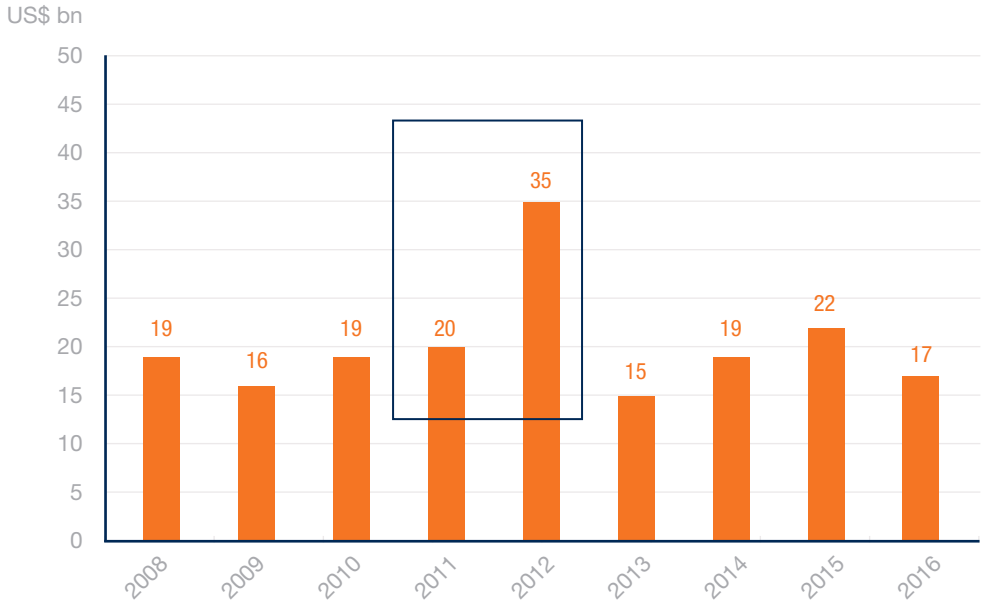
## India's Domestic Pharmaceutical Market Composition




Source: Nomura Research

Looking at the industry in 2011 and 2012, it appeared that there would be a significant decline in growth, as total sales of drugs going off patent in the US was set to fall significantly in 2013. However, the 2012 peak was driven by the Lipitor patent expiry, which, because of a collapse in pricing, generated very little profit for industry participants.

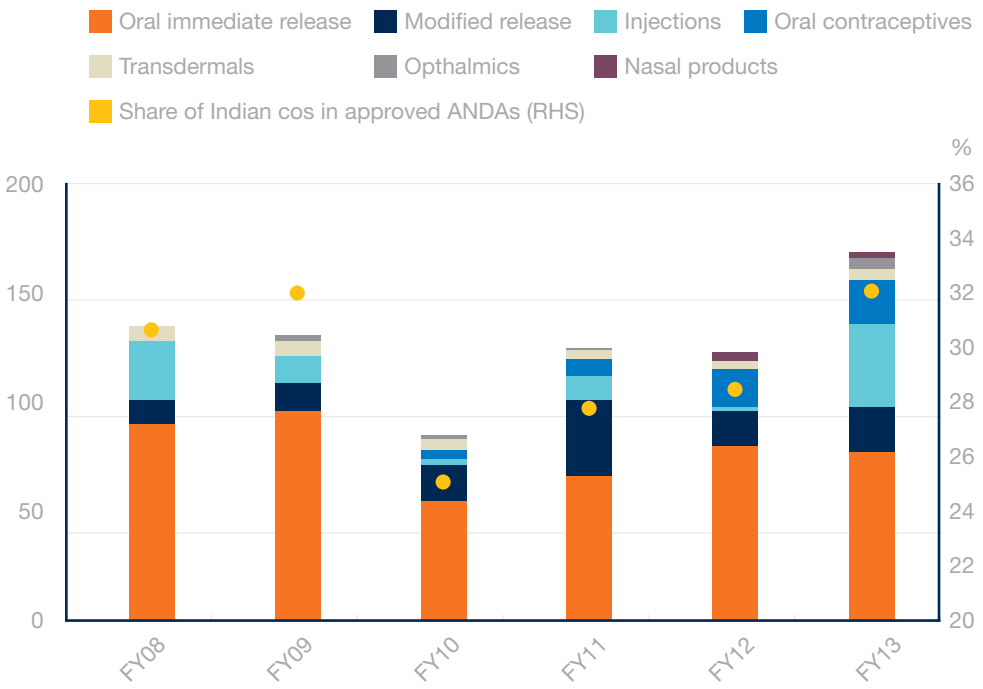
## US Total Branded Sales of Drugs Going Off Patent by Year




Source: Company Data, CIMB

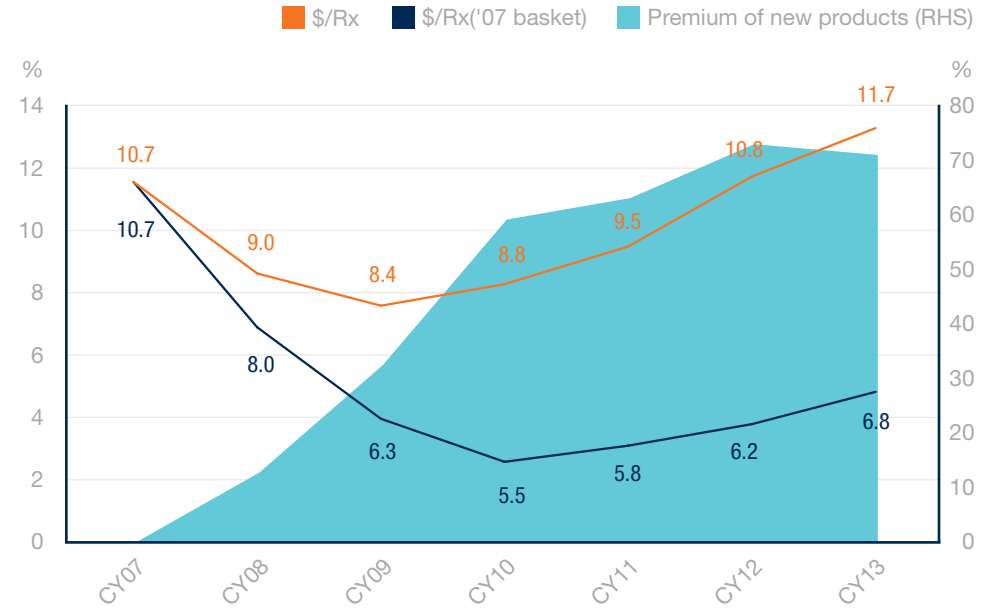
Beneath the surface, most Indian generics companies, starting years ago, realized that the key would be less competitive filings, which could generate higher margin sales and be more sustainable. This has created a dynamic whereby some large products that go off patent see under 10 competitors compared to a decade ago when those products would see 15 or more competitors, which translated into less market share and worse pricing for all. In addition to the bigger products becoming less competitive, low value branded products are seeing generic competition that they used to not see, as we're seeing 2-3 generic filers on products in the $50-100mm sales range, and we used to see only 1-2 and sometimes none at all. The chart below on the left illustrates the change in filings over time and how the Indian companies are executing on this strategy. We can also see from the chart on the right below that this competitive landscape that is broader, but shallower, has resulted in a market with more favorable pricing and margins.

## US Filings by Indian Companies




Source: US FDA, Standard Chartered

### $ / Rx trajectory for key Indian Generis firms in the US (vs. the 2007 product basket)




Source: IMS Data, Barclays Research

We believe that with the continued dedication to R&D investment and the depth and breadth of filings that the Indian companies have, they will continue to gain market share in the US, which will continue to drive earnings for these companies for years to come.

# Mobile's Monetization Movement

As the large buildout of the 3G/4G infrastructure globally is nearing completion, the focus is now on software development for the mobile ecosystem. This development has manifested itself in the form of a land grab for users on each mobile platform. Messenger apps stand out in terms user engagement and reach, which explains the turf war and acquisition activity. What is worth noting is that Asian companies are actually leading the way globally with more innovative and creative business models with messenger apps.

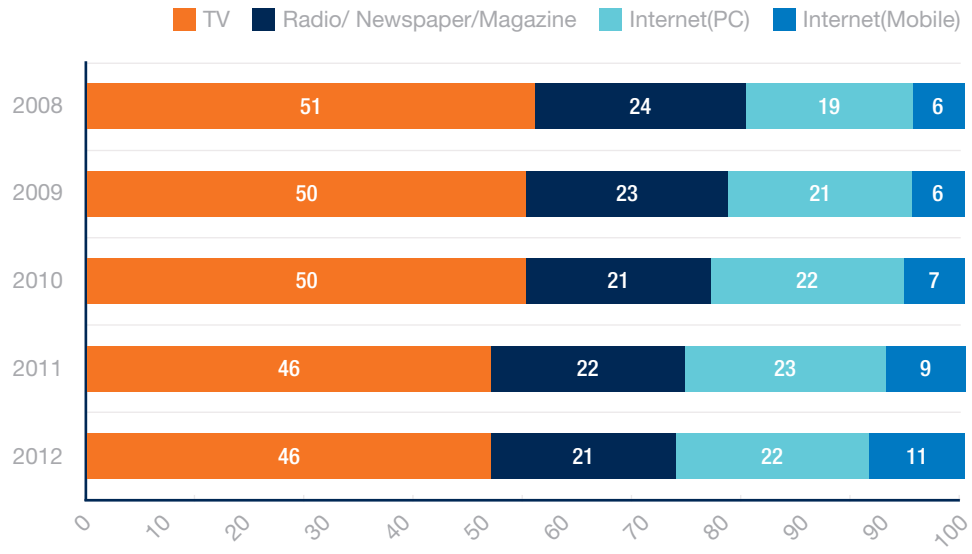
We believe that in Asia, messenger app services will continue to expand in the next few years driven by further smartphone penetration, wireless data infrastructure improvement, affordability, and a strong push from large internet companies. Messengers are quickly evolving into full service platforms and looking to monetize their user base through their ecosystem, including advertising, offline to online (O2O)/e-commerce, and payments.

## **Advertising-** it's simple, it's all about user time spend and user engagement

Companies spend money to advertise where people are looking, and this has always held true, whether it's a billboard on a highway, a spread in a magazine, an online ad, and now ads on Facebook, messengers, and so on. Facebook generates over 50% of revenue from mobile, and its average revenue per user (ARPU) on mobile is also higher than on a PC. Given that advertising trends in the US match Korea and Japan, it suggests that the advertising dollar shift from traditional media will continuously move to mobile to catch the eye balls from mobile devices. In Japan for example, Internet time-spent share has grown to over 33% of total media time-spent in 2012 from 25% in 2008; furthermore, within the internet, the mobile internet mindshare portion has seen its mix double during this period. Globally, the trends are similar.

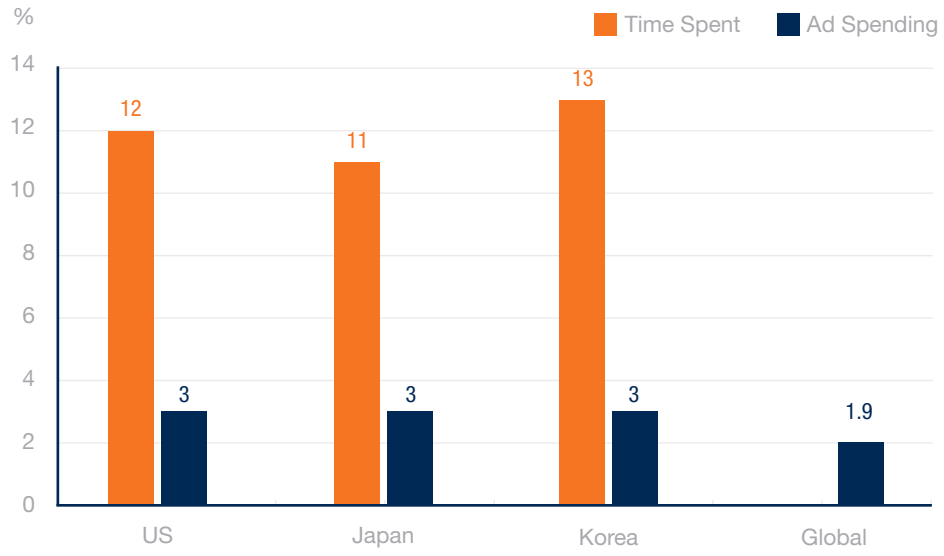
From a marketing perspective, as people spend more time looking at their mobile devices, companies are willing to pay a higher ARPU for these ads, which is justified by higher return on investment (ROI) on their marketing spend. Messenger apps play an important role on mobile devices as they are the most frequently used apps. Third party data suggests that Whatsapp is averaging 100 messages per user per day, and LINE sends over 30 messages per day per user. The social, user reach, and time-spent aspects of this utility app are very valuable to all businesses.

## Japan consumers' mind share mix by media




Source: Hakuhodo DY Media Partners / Institute of Media Environment, May 2013

## Disproportionate time-spent and ads spending




Source: IAB, MagnaGlobal, Macquarie Resarch, September 2013

We ultimately believe that the successful messenger aps will be multifunctional, driving users to spend even more time on them, as well as making them more advertiser friendly. LINE is one of the most advanced, as it offers official accounts where advertisers create their own account by paying a monthly subscription fee and their accounts would be followed by users. They can distribute coupons, send new product updates and special events invitation to the followers. O2O is another example of how advertising engagement can be promoted.

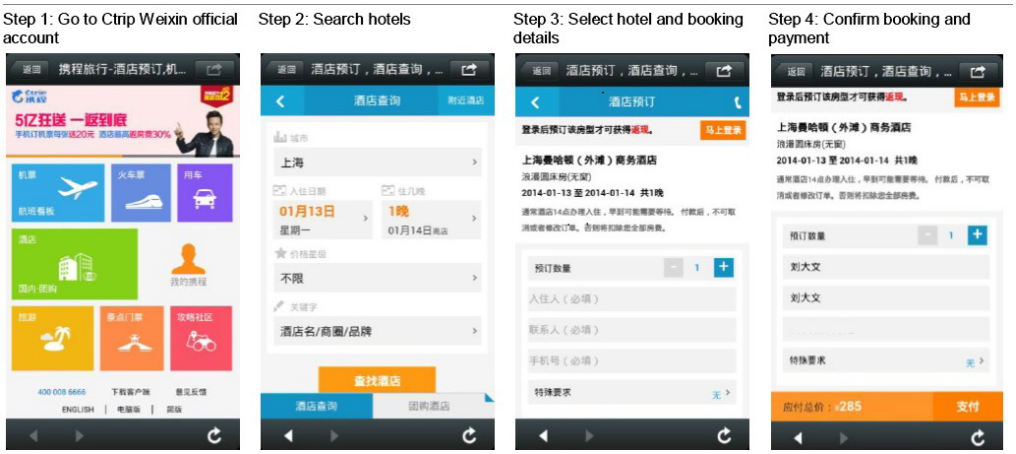

Jill Stuart Japan using LINE to send out coupons for users to use at offline retail stores. This is also a form of O2O


7-11 using LINE's official account for product and event promotions

## Offline to online (O2O) /E-Commerce

The O2O is not a new concept, but thanks to mobile devices, it is becoming more and more creative and can take on various forms. Offline merchants can benefit from it tremendously if used effectively. An example of O2O model within a messenger app is WeChat's recently opened dedicated public account for Dianping.com, China's largest dining review website (similar to US site Yelp.com). The account enables WeChat users to search for group-buy deals based on location and make purchases of these deals in just a few clicks within the platform. Another vertical that enjoys large usage is for travel, namely hotel booking (see chart below). Users can book a travel ticket within the WeChat platform, and can complete the transaction with WeChat's payment service. Monetization could take on many forms depending on Tencent and the merchants' agreement, and could include a commission, a cost per click, or other fees.

Booking tickets/hotels through Ctrip WeChat official accounts (on WeChat platform)




Source: photo from Standard Chartered Research

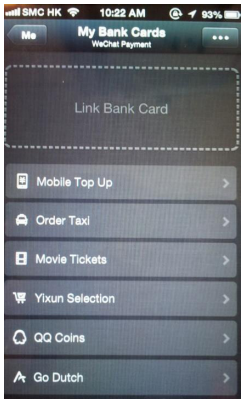
## Payment

In many parts of the world, credit/debit cards have replaced the need to carry cash. Going forward, we can only imagine this trend getting more pronounced as mobile devices can come to replace the use of both cards and cash. The infrastructure is incomplete, but the speed of improvement is astonishing. iResearch, a third party research company in China, forecasts that the third party payment market in China will reach over Rmb1.3 trillion (USD 208 billion) by 2016, which is 2% of China's GDP.

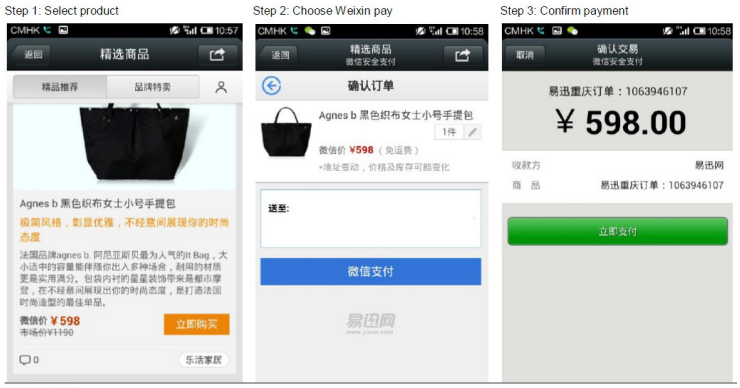
WeChat encourages users to link their bank accounts to their WeChat account, enabling simple mobile payments for online transactions. Back to our example of Dianping, one month after the launch of their official account on WeChat, Dianping saw its sales expand seven-fold on the platform, as it became easily useable to many more people on a fully integrated platform. Another frequently used payment function is for calling a taxi. Users can locate taxis nearby, and, in just a few clicks, the selected taxi will arrive at the designated location. Furthermore, users can chose to pay the taxi driver using Tencent's payment service (Tenpay). Each of these functions is fully integrated within WeChat's easy to use platform.

Internet companies are going through a transitional period, as they become better integrated with both online and offline functions, enhancing productivity and convenience. We believe that this trend can only become more pronounced due to consumers continuing to embrace online functions and companies continuing to innovate.

Tencent WeChat's payment main page




Example of purchasing a bag on Tencent's Yixun (e-commerce platform) on WeChat platform, and using Tenpay payment.




Source: Tencent

# Investment principles

## We identify the sustainable competitiveness of companies

### What does it mean to us?

We believe companies that have strong moats will have stable earnings growth and cash flow, and share prices will rise as these companies add considerable value each year. This tenet drives our investment ideas, not short-term trading profits.

### How do we apply it?

Sustainable competitiveness scorecards: We thoroughly analyze 30 factors for each company to identify the competitiveness of the company for the long term. This scorecard includes six main categories, which are: Barriers to Entry, Competitive Dynamics, Sustainability of Returns, Management Track Record, Reliance on Outside Support, and Ownership of Distribution/Production Supply Chain.

Extensive company meetings and research trips: Third party research is useful for us to know the consensus, but it cannot be the sole input when making investment decisions. We have investment professionals around the globe; we frequently hold meetings in our offices and conduct numerous on-site visits and meetings.

## We invest with a long term perspective

### What does it mean to us?

Many of our investors are investing with us for their retirement, or even for their children. Long-term does not mean only three to five years for us. Our goal is to find companies that can last and prosper in the next several decades and invest in them – these are companies with high terminal values.

### How do we apply it?

Analysts and portfolio managers are evaluated by their long-term performance. To add a new position into a fund, we spend considerable time researching and evaluating it. We're not looking to rush in based on a news headline, we are more concerned with generating solid, long-term, well researched ideas.

## We assess investment risks with expected return

### What does it mean to us?

We constantly monitor the changes in regulation, competitive environments, and managements strategies. We do not fall in love with our holdings, and will exit a position when the investment thesis is no longer valid. The potential upside and downside and our conviction drives the sizing of our positions.

### How do we apply it?

In addition to risk analysis done by research team, where we quantify the upside and downside to earnings and valuation, our risk team monitors various parameters including sector volatility and liquidity, and gives active feedback to the research team. Our risk team is aided with a range of third-party risk management systems such as Factset, Axioma, Thomson Reuters, and Bloomberg POMS/AIM.

## We value a team based approach in decision making

### What does it mean to us?

We do not rely on any single star portfolio manager or star analyst. We believe in sharing information and analysis among ourselves. We rely on our collective knowledge and invest in long-term ideas.

### How do we apply it?

We openly discuss and examine key ideas in Investment Committee meetings where investment professionals participate.

We share our research notes globally on MARS (Mirae Asset Research System) online, over email and we have regular video conference calls with other overseas offices.

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