

Korea

21 July 2005

Oon M. Bak
+82-2-768-4158
ombak@bestez.com

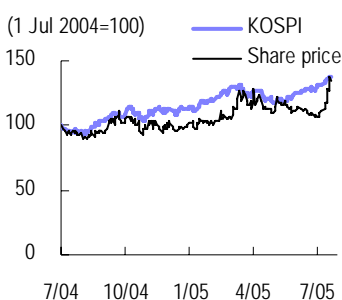
Overweight

Maintained

Ticker: 000140.KS
Share price (20/07/05): W112,500
Price target (6mos): W145,000
52-Wk Hi/Lo: W114,000/74,000
Market cap: US\$2,124.2mn
W2,205.3bn
Shares issued: 20.0mn shr
Foreign ownership: 36.57%
Major shareholders:
Moon-Duck Park (18.4%)

Price performance (%)

	1M	6M	12M
Absolute	24.0	32.4	44.0
Relative	14.8	12.0	-1.2



Hite Brewery (000140.KS)

Focus on synergies with Jinro acquisition

- Fair Trade Commission finally approved Hite's acquisition of Jinro, on conditions that would limit ASP hike and consolidation of sales forces for 5 years
- Less strict-than-expected conditions are likely to work in favor of Hite
- Jinro is likely to recover from capital erosion once the Hite consortium completes the acquisition process
- Maintain **Overweight** and raise a six-month target price to **W145,000** to reflect potential synergies from Jinro acquisition

FTC approved Jinro acquisition on softer-than-expected conditions

The Fair Trade Commission (FTC) has finally approved Hite's acquisition of Jinro, but on certain conditions. Although FTC ruled that soju and beer belong to the separate markets, it set the following conditions: 1) Price increases in soju and beer should be within the range of the overall consumer price increase for the next five years, 2) the consolidation of distribution channels is prohibited for the next five years, 3) shipment volume to liquor wholesalers is required on a semi-annual basis for the next five years, and 4) Hite should come up with antitrust measures within three months.

We view FTC's conditions came out less strict than expected as it did not contain a strong term such as the market share restriction. Jinro is likely to be out of court receivership during 2005 and go public in three years (by 2007).

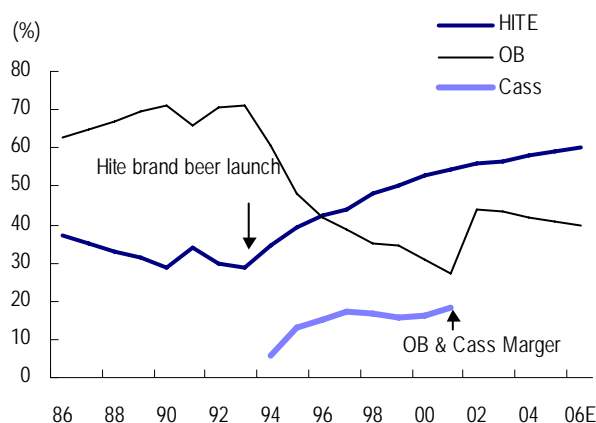
Sustainable synergies from Jinro acquisition

Hite controls 59% of the beer market, while Jinro controls 55% of the soju market in Korea. As such, we expect the following synergies from the Jinro acquisition.

- 1) With its dominant market leadership, Hite will be able to attract more foreign investors.
- 2) Hite can expect substantial cost savings by sharing the distribution channels and logistics with Jinro.
- 3) Hite can expect to increase the market coverage through joint marketing with Jinro. For instance, Hite could actively utilize Jinro's strong distribution channels in the Seoul metropolitan area where Hite is relatively weak. On the other hand, Jinro could expand its market share in the southeastern province where Hite mainly dominates. With the announcement of the Jinro acquisition, Hite is already witnessing an increase in the number of customers in Seoul metropolitan area.
- 4) The acquisition of Jinro could prevent competitors from entering the liquor market. The beer industry has a high entry barrier by nature. We expect the domestic beer market to be shared by Hite and OB. The potential risks include the competition with imported beers.

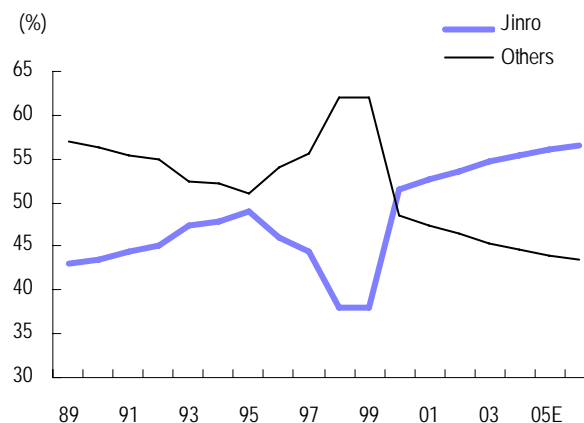
However, we view the imported beers would have a limited impact due to the following disadvantages: 1) the ASP in imported beer is twice as high as the domestic beer due to a 30.0% tariff, 2) Korean consumers are less receptive to imported beers due to their relatively bitter tastes and possible lack of freshness (delivery period, etc.), and 3) most of all, distribution channels for imported beers are very weak. Moreover, once Hite completes the Jinro acquisition, imported beers are likely to struggle with securing distribution channels.

Figure 1. Hite's beer market share



Source: Daewoo Securities

Figure 2. Jinro's soju market share



Source: Daewoo Securities

Future financing plans for Jinro acquisition

The acquisition value, which finally came in at W3,428.8bn, includes equity financing through right issues amounting to W2.4tr (70.8%) and borrowings of W1.0tr (29.2%). The W1.0tr borrowing, which will initially be based on Hite's credit, would be converted as Jinro's debt three months later. Hite is likely to invest W1.3tr to acquire a 52.2% stake in Jinro.

Hite invested W70bn upon the MOU agreement (April 8) and has already made an upfront payment of 10.0% (W342.8bn=W70bn+W272.8bn) of the total acquisition value. This was funded with W300bn worth of CBs (W230bn from Korea Teachers Credit Union (KTCU) and W70bn from Dongbu Securities), which were issued in end-March 2005 (with 1.0% coupon rate, exercise period beginning March 31 2006E at W115,000/sh).

We believe it requires W925bn for Hite to completely acquire Jinro, of which W200bn~300bn has been secured so far through its reserves and short-term borrowings. The remainder will be funded through issuance of corporate bonds or long-term borrowings. The interest rate is expected to be low around 4%.

We view Hite does not have to hold the entire 52.2% stake. The company might sell off some of it afterwards.

Figure 3. Financing details for Jinro acquisition

	Amount (Wbn)	(%)	Stake Owned (%)
Total acquisition value (A+B)	3,428.8	100.0	
Total equity raisings (A)=C+D+E+F+G	2,428.8	70.8	-
Hite Brewery (C)	1,267.8	37.0	52.2
CB	300.0	8.7	-
Borrowings	200.0	5.8	-
Others	767.8	22.4	-
Korea Teachers Credit Union (D)	400.0	11.7	16.5
Military Mutual Aid Association (E)	510.0	14.9	21.0
Korea Development Bank (F)	100.0	2.9	4.1
Others (G)	150.0	4.4	6.2
Borrowings (B)	1,000.0	29.2	-

Note: The W1.0tr borrowing, borrowed on Hite's credit, would be converted to Jinro's debt three months later.

Source: Company data, Daewoo Securities

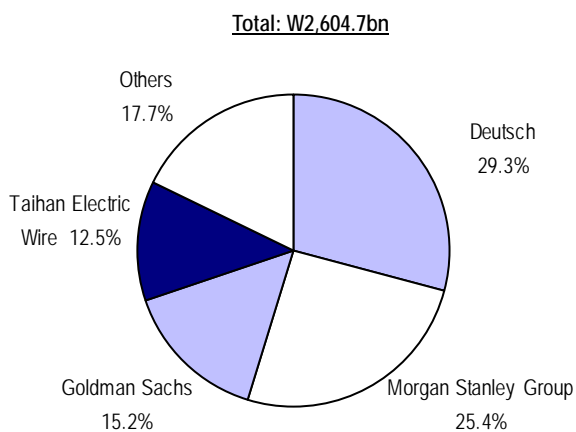
Jinro to be reborn as a clean company

When the deal is completed, Jinro's paid-in capital will amount to W2.4tr (300m shares with par value at W8,000). The proportion of the equity financing is higher than expected. We view the court may have required heavy capital investment in order to help Jinro get out of capital erosion.

Jinro's debt currently stands at W3.0tr, of which W2.0tr is final and W1.0tr remains to be finalized depending on the pending lawsuit. Given the W3.4tr coming in from the acquisition, W400bn in cash remains for Jinro even after clearing out its W3.0tr debt. In addition, the W1.0tr debt volume may be reduced depending on the outcome of the lawsuit. Jinro currently holds cash reserves and non-operating real estate property amounting to W500bn and W100bn, respectively. All in all, we estimate W1.0tr asset will remain for Jinro.

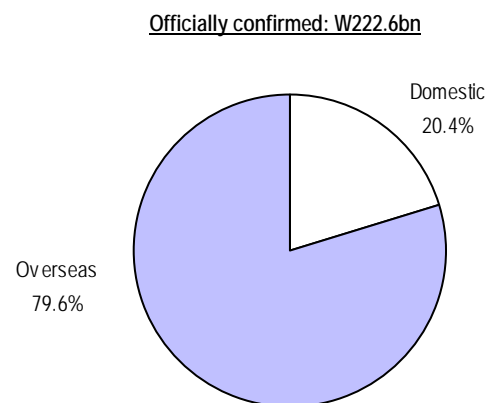
Following the Jinro acquisition, we view Hite may proceed the sale of Jinro Japan, of which the price is estimated at W400~600bn. Once Jinro's operation turns back to normal, Hite may seek to retrieve its investment through measures such as capital reduction.

Figure 4. Jinro's debt volume



Source: Hankyoreh Economy 21, Daewoo Securities

Figure 5. Jinro's debt volume (officially confirmed)



Source: Hankyoreh Economy 21, Daewoo Securities

Figure 6. Jinro's forecasts

(Wbn)	02	03	04	05E	06E	07E
Sales	590.4	650.9	724.4	765.0	808.0	851.0
% yoy		10.2	11.3	5.6	5.6	5.3
Alcoholic liquors	557.7	619.9	691.9	730.0	770.0	810.0
% yoy		11.2	11.6	5.5	5.5	5.2
Bottled water	32.7	31.0	32.5	35.0	38.0	41.0
% yoy		-5.2	4.8	7.7	8.6	7.9
Gross profit	252.6	294.8	351.4	350.0	356.0	370.0
Gross margin (%)	42.8	45.3	48.5	45.8	44.1	43.5
SG&A Expenses	156.6	146.1	139.9	160.0	178.0	188.0
% yoy		-6.7	-4.2	14.4	11.3	5.6
EBIT (Operating profit)	96.0	148.7	211.5	190.0	178.0	182.0
Depreciation	27.2	24.5	22.2	23.0	23.0	23.0
EBITDA	123.2	173.2	233.7	213.0	201.0	205.0

Source: Underwriters, Daewoo Securities

Financial risks to be insignificant

We estimate Hite to pay the interest expense of W40bn~50bn per year for the financing of Jinro acquisition. Hite's EBITDA is likely to reach W250bn~300bn for 2005E~2006E and it may increase when considering the potential synergies from Jinro.

Hite could also expect W40~50bn in equity method gains from Jinro's core operating value excluding goodwill amortization. As such, although the Jinro acquisition may result in a temporary increase in borrowings, we do not expect significant financial risks.

For reference, the Jinro acquisition may distort the financials of Hite due to an occurrence of the goodwill amortization (W120~130bn per year for 20 years). However, this does not have any influence on the actual cash flows.

The market expects Jinro's need for massive facility investment once the acquisition is completed. However, unlike beer that uses fermentation method, the facility investment for Soju production should be smaller in size as it applies the dilution method.

Figure 7. Impact of Jinro acquisition on Hite's financials

(Wbn)	02	03	04	05E	06E
Borrowing	606.7	661.8	601.1	1,670.0	1,625.0
Existing	606.7	661.8	601.1	570.0	525.0
New				1,100.0	1,100.0
Interest expense	45.4	42.1	36.5	75.0	75.0
Existing	45.4	42.1	36.5	35.0	35.0
New				40.0	40.0
Equity method gains	0.0	0.0	7.1	59.0	59.0
Existing	0.0	0.0	7.1	9.0	9.0
New				50.0	50.0
Goodwill amortization	11.8	4.2	0.0	120.0	120.0
Existing	11.8	4.2	0.0	0.0	0.0
New	0.0	0.0	0.0	120.0	120.0

Source: Company data, Daewoo Securities

Maintain Overweight and raise target price to W145,000

As one of the consumer cyclical plays, we expect Hite’s earnings to turn upward in 2005 as it is expected to benefit from sales growth and ASP increases beginning 3Q05E. In addition, synergies from the Jinro acquisition is likely to have a sustainable impact on Hite given that the conditions set by FTC turned out less strict than expected.

Hite has received sound valuations since 1990’s, applying over 60% premium to the F&B sector average P/E. However, such valuation gaps have been reduced to 30% as the share price rally in the F&B sector has brought up the sector average P/E to 12.7X in 2005. This may dissipate market concerns that Hite is overvalued.

Given the ever-solid market leadership through the Jinro acquisition, we believe Hite deserves P/E multiples of the leading domestic consumer plays such as Shinsegae (004170.KS), S1 (012750.KS) and AmorePacific (002790.KS). We maintain our **Overweight** rating and raise our six-month target price to **W145,000** from W120,000.

Korea is the world’s 14th largest beer consumer. Hite is the leading domestic beer producer, claiming a 59.0% market share. Hite’s comparable peers may include the Asian and South American breweries. Breweries in the US and Europe should be inappropriate for comparison as beer consumption is diminishing and many of the breweries are multinational players.

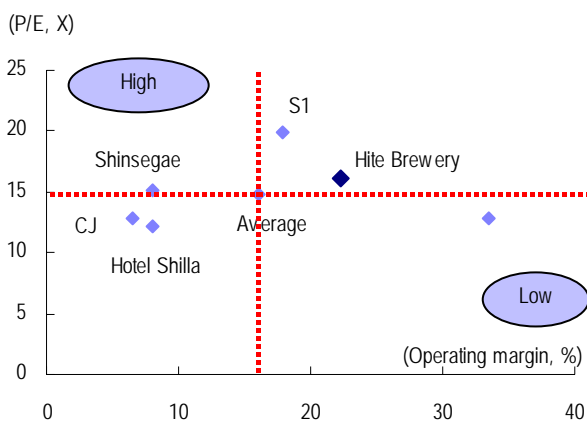
Hite seems relatively undervalued compared to its comparable peers such as Tsingtao (China), Kirin, Asahi and Sapporo (Japan), San Miguel (Philippines) and Grupo Modelo Sa (Brazil).

Figure 8. Forecasts/Valuations

FY	Sales (Wbn)	yoy (%)	OP (Wbn)	NP (Wbn)	EPS (W)	FCF (Wbn)	ROE (%)	P/E (x)	P/BV (x)	EV/EBITDA (x)
12/02	793.7	4.7	216.5	105.0	5,253	-35.7	14.5	9.3	1.3	5.6
12/03	822.3	3.6	214.4	114.1	5,694	33.3	14.2	15.3	2.1	8.4
12/04	860.8	4.7	174.8	110.2	5,499	95.2	12.6	15.5	1.9	9.2
12/05E	932.9	8.4	207.3	136.9	6,832	105.5	14.1	16.5	2.2	10.1
12/06E	1,007.7	8.0	239.9	162.9	8,128	112.5	14.8	13.8	1.9	8.7

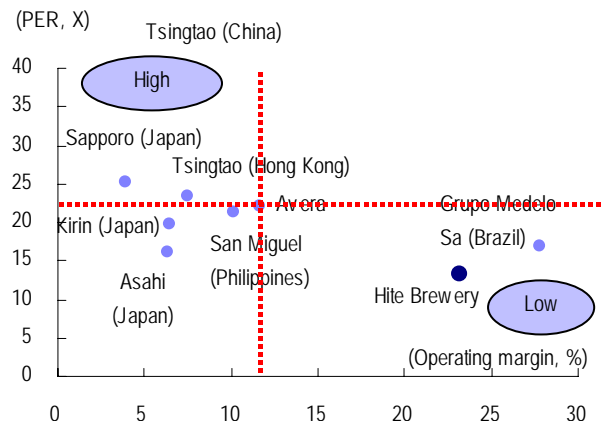
Source: Company data, Daewoo Securities

Figure 9. Comparison of valuations among domestic consumer peers



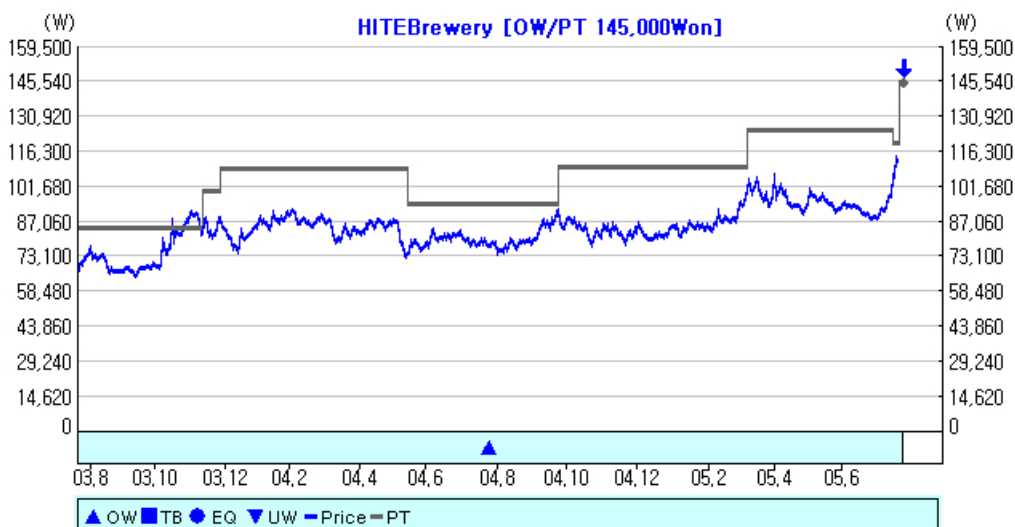
Source: Daewoo Securities

Figure 10. Comparison of valuations among global peers



Source: Thomson Datastream, Daewoo Securities

Record of Ratings and Target Prices of the Subject Company



Rating Allocation

	% of companies under coverage	% for which IB services have been provided
Overweight	64.29%	10.64%
Equal-weight	35.71%	12.92%
Underweight	0.00%	0.00%

As of July 15, 2005

Source: Equity Research for International Investors, Daewoo Securities

Important notices to continue to next page

DAEWOO SECURITIES INTERNATIONAL NETWORK

DAEWOO SECURITIES CO., LTD

150-716, 34-3, Youido-dong, Yongsongpo-ku, Seoul, Korea
 Tel : (822) 768-3750 Fax : (822) 768-2863
 Contact: Chris Kim chriskim@bestez.com

Daewoo Securities (Europe) Ltd.

41st floor, Tower 42, 25 Old Broad Street,
 London EC2N 1HQ, U.K.
 Tel : 4420-7982-8000 Fax : 4420-7982-8040
 Contact: Paul Song paul.song@dws.com

Daewoo Securities (Hong Kong) Ltd.

Suite 816-819, Jardine House,
 1 Connaught Place, Central, H.K., China
 Tel : 852-2845-6332 Fax : 852-2845-5374
 Contact: H. J. Ahn hjahn@dws.com.hk

Daewoo Securities (America) Inc.

600 Lexington Avenue, Suite 301
 New York, NY 10022 U.S.A.
 Tel : 1212-407-1000 Fax : 1212-407-1010
 Contact: J. Kim jaewookim@dwsusa.com

Uz-Daewoo Bank

1 Pushkin Street, Tashkent, 700000, Uzbekistan
 Tel : 998-71-1320640 Fax : 998-71-1206970

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Risk Rating	Target Return
Overweight	> +15%
Equal-weight	-15% - +15%
Underweight	< -15%

- Rank is a guide to the expected total return over the next 6-12 months unless separately specified otherwise.
- The target return is relative to the market index, which is assumed to be constant at current level.
- Although it is not part of the official ratings at ERII, we may call a trading opportunity in case there is a technical or short-term material development.

Analyst Industry Ratings of ERII, Daewoo Securities

Positive	Industry fundamentals are improving
Neutral	Industry fundamentals are steady without any material changes
Negative	Industry fundamentals are worsening