

Korea Internet

New strategies to fire up the sector

Equities Internet Software & Services

Korea

- ◆ It has been a tough time for the Korean internet sector as the slowing economy has hit advertising and online shopping...
- ◆ ...but we think it is time for a fresh look; we see margins rising as the leaders focus on niche advertising and content
- ◆ Upgrade Kakao to Buy; prefer Kakao to Naver (Buy); initiate Buy on leading e-commerce firm Coupang in a separate report

Margins to the rescue: Korea's internet sector has fallen out of favour as revenues have dried up from two key sources: advertising and online shopping. However, we believe the two local internet giants, Naver and Kakao, can boost their margins on: **1)** better-than-expected ad sales by focusing on niche advertisers, **2)** consolidation in the e-commerce market, and **3)** upside from content like popular web cartoons.

- ◆ **Ads and e-commerce:** Naver and Kakao have faced the double impact of cost pressures, especially labour costs, and slowing top-line growth as the economic downturn led large advertisers to pull back on ad spending. However, we believe focussing on smaller, niche advertisers that are less sensitive to economic conditions will aid margins. We also expect consolidation in the e-commerce market and believe the core internet companies can improve their profitability by investing more in loyal customers; we see wage cost pressures easing in 2023e.
- ◆ **Upside from content:** Naver and Kakao are focusing on webtoons – the term used to describe online cartoons in Korea – as they see them as a growth driver. The two companies generate revenue by not only distributing webtoons on their platforms but also using the content to create videos. The importance of original content is rising amid streaming competition and webtoons are heading overseas as they are one of the lesser-known parts of the “Korean wave” of cultural exports. Although Naver and Kakao are making a loss in the global webtoon business on high marketing costs, we believe earnings can turn positive once the all-important gross merchandise value (GMV) for the global webtoon business jumps after a long period of investment, given the average revenue per paying user (ARPPU) in Japan, the US and Europe is much higher than in Korea.

Kakao to Buy (from Hold): We see Kakao's revenue recovering rapidly as it shifts its focus to high-margin parts of advertising and commerce along with cost controls. **We prefer Kakao to Naver (Buy)** where we see solid earnings growth but less dynamic business changes. For **Coupang (Buy)** see page [37-38](#) and [Initiate at Buy: Ready to become the market leader](#), 6 October 2022.

With this report, Junhyun Kim assumes primary coverage of Naver and Kakao.

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Key changes to ratings and estimates

Company	Ticker	Currency	Current Price	Target Price		Rating		Upside/ Downside	Market Cap (USDm)	3m ADTV (USDm)	2023e PE (x)	2023e PB (x)	2023e ROE
				Old	New	Old	New						
Kakao	035720 KS	KRW	55,900	90,000	91,000	Hold	Buy	62.8%	16,984	82	29.1x	2.0x	7.1%
Naver	035420 KS	KRW	176,500	360,000	270,000	Buy	Buy	53.0%	18,416	98	17.5x	1.1x	6.5%
Coupang	CPNG US	USD	19.56	-	27.80	Buy	Buy	42.1%	34,526	118	TTB	17.2x	0.8%

Source: Bloomberg, HSBC estimates. Priced as of close at 4 October 2022. TTB = Turn-to-Black

Disclosures & Disclaimer

This report must be read with the disclosures and the analyst certifications in the Disclosure appendix, and with the Disclaimer, which forms part of it.

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Key charts

Exhibit 1: The Korean internet sector has been under pressure so far this year

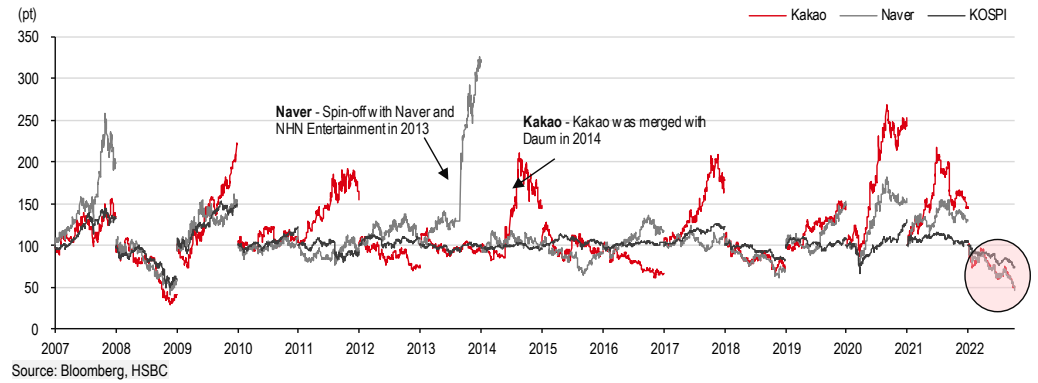


Exhibit 2: Kakao – We expect a rebound in Talk Biz sales y-o-y growth in 2H22e

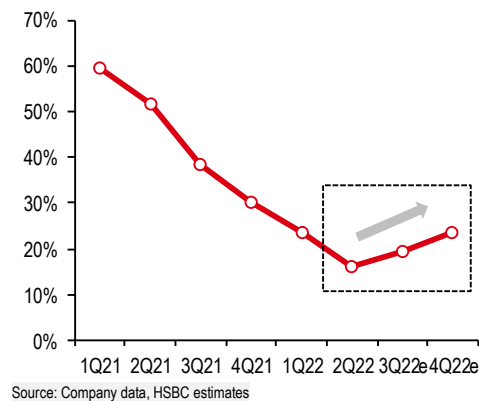


Exhibit 3: Kakao – We focus on OP margin improvement in 2023e

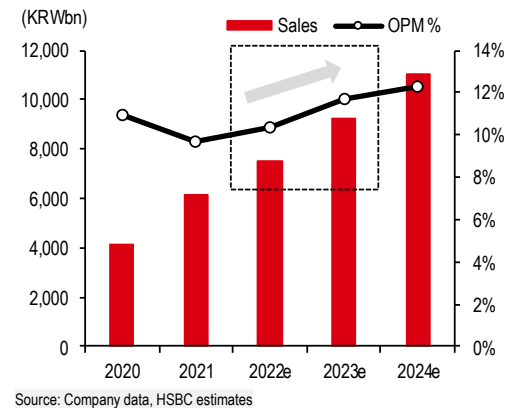


Exhibit 4: Naver – Slowing quarterly sales y-o-y growth and low OP margins have dented investor sentiment...

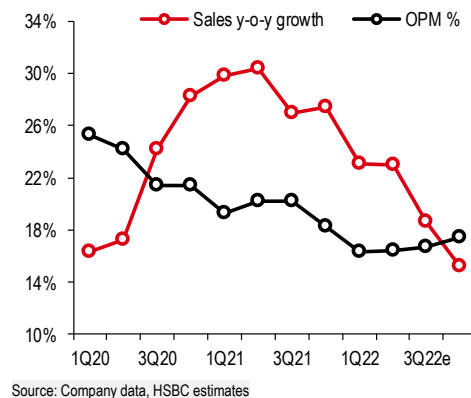


Exhibit 5: Naver – ...but we see a potential margin pick-up starting from 2023e

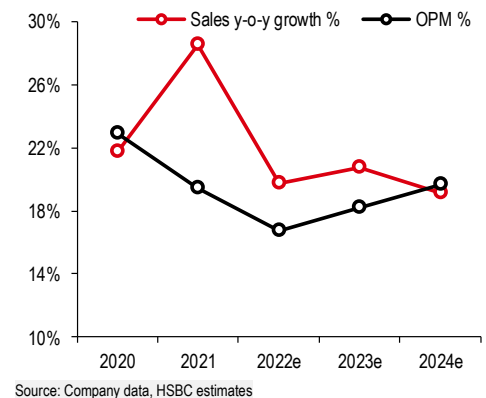
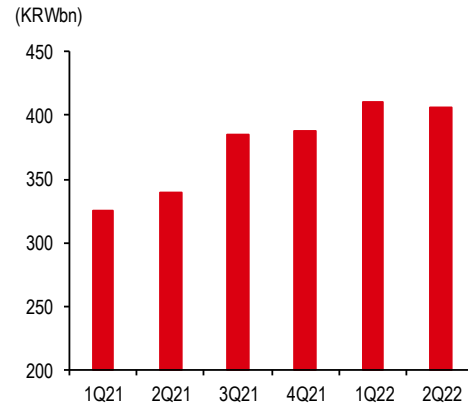
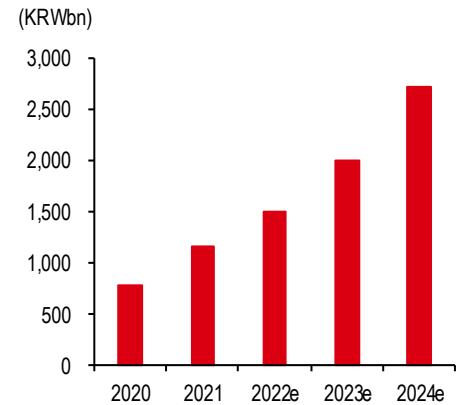
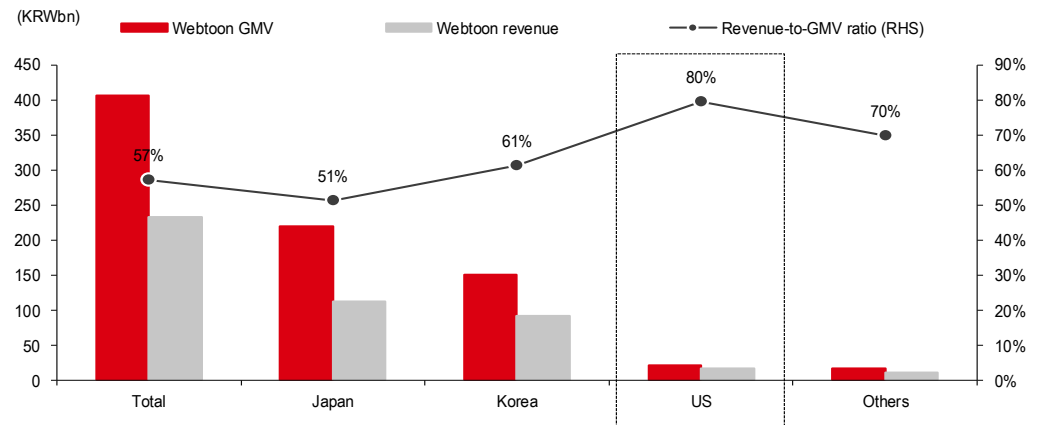


Exhibit 6: Naver – Quarterly webtoon global GMV trend


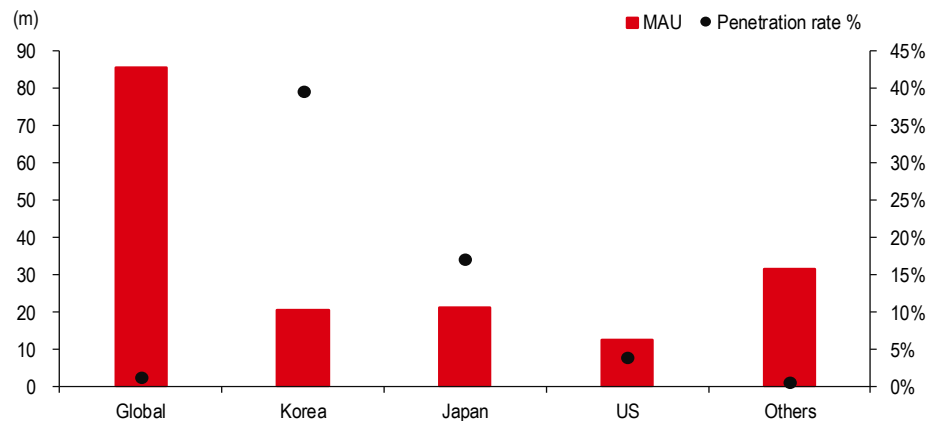
Source: Company data

Exhibit 7: Kakao – Annual platform GMV trend related to the Story business


Source: Company data, HSBC estimates

Exhibit 8: Naver – Webtoon KPI: US and other overseas markets show a much higher GMV-to-revenue conversion ratio (as of 2Q22)


Source: Company data

Exhibit 9: The global webtoon market is in an initial growth stage


Note: Numbers can be different from actual data as the numbers are based on HSBC calculations using Naver's Webtoon MAU (as of 2Q22) and population. Penetration rate is calculated by dividing Naver's Webtoon MAU by the total population. MAU refers to the number of monthly average users.
 Source: Company data, Statistics Korea, HSBC

Exhibit 10: Key comparison between Naver, Kakao and Coupang

Company	Naver	Kakao	Coupang
Ticker	035420 KS	035720 KS	CPNG US
Market Cap	KRW28,545bn	KRW25,205bn	USD34.53bn
Target Price (KRW, USD for Coupang)	270,000	91,000	27.80
Rating	Buy	Buy	Buy
Price (KRW, USD for Coupang)	176,500	55,900	19.56
Upside (%)	53%	63%	42%
Key service	Naver (internet portal) Naver Shopping (e-commerce) Naver Webtoon (webtoon)	Kakao Talk (messenger service) Talk Gift (e-commerce on the Talk platform) Bizboard (ads on the Talk platform)	Coupang (e-commerce platform) Coupang Eats (food delivery service) Coupang Play (video content app)
Sales breakdown (2Q22)	Search platform (c44%) Commerce (c21%) Fintech (c14%) Content (c15%) Others (c5%)	Platform (51%)/Content (49%) Platform - Talk Biz (49%)/Portal Biz (11%)/Others (40%) Content - Game (38%)/Music (23%)/Story (26%)/Media (13%)	Product commerce (97%) Developing offers (3%)
OPM			
2021	+19%	+10%	-8%
2022e	+17%	+10%	-3%
2023e	+18%	+12%	0%
2024e	+20%	+12%	+3%
Paid membership	Naver Plus membership	NA	Coupang Wow membership
Key positives	OP margin expansion through the growth recovery in Commerce; potential margin recovery in the global webtoon business		Fast GMV growth and the improving profitability
Key risks	1. Intensifying competition in the domestic ad market could be a threat to margins; 2. potential market share loss in e-commerce; 3. unexpected cost hikes driven by global business expansion, which could deteriorate margins; and 4. regulatory risks.	1. Potential regulations that can threaten Kakao's margin recovery; 2. increasing competition from Naver in fintech and the content business; 3. a more significant increase in marketing or labour costs versus our estimates; and 4. delays in new business monetisation and new service launches like the independent open chat app.	1. SoftBank (9984 JP, JPY5,235, Hold) stock overhang; 2. an economic downturn; 3. a fall in user numbers; and 4. FX changes can affect USD-based reported earnings as most revenues are in KRW.

Source: Company data, HSBC estimates. Note: Priced as of 4 October 2022. NA – Not applicable/available.

Contents

Key charts	2
Light at end of the tunnel	6
Macro uncertainties continue	6
Why do we expect a potential margin pick-up?	7
Upside from the webtoons business	15
Tough environment, but we think we have hit the trough	21
Where can we be wrong?	22
Company section	24
Kakao (035720 KS)	25
Financials & valuation: Kakao	26
Naver (035420 KS)	31
Financials & valuation: Naver	32
Coupang (CPNG US)	37
Ready to become the market leader	37
Financials & valuation: Coupang Inc	38
Disclosure appendix	39
Disclaimer	43

Light at end of the tunnel

- ◆ We believe it is time to turn more positive on the Korean internet sector after the recent sell-off driven by the challenging economy
- ◆ We see a potential margin recovery and global expansion in content
- ◆ Attractive valuations are positive for Kakao and Naver, both rated Buy

Macro uncertainties continue

Korea's internet sector has taken a beating in the last year. Why? Revenue comes from advertising and e-commerce and both of those markets are in the doldrums. Advertisers usually tighten their marketing budgets during an economic downturn. It is the same for consumers who generally hold off spending when inflation is rising, especially on non-essentials, while higher interest rates increase the interest they need to pay on loans.

It has been particularly "painful" for Korean internet companies as well as their expansion into content (e.g. webtoons, which are Korea's popular cartoons published online) has been expensive, given heavy marketing costs to attract global users. As a result, internet platform giant Naver's OP margin dropped to 16% in 2Q22 from 25% in 1Q20 and Kakao, operator of the popular Kakao Talk app, continued to struggle to improve its margin, recording an OPM of 9% in 2Q22 (vs. 13% in 1Q21). As a result, Naver and Kakao have underperformed the KOSPI by 22ppt YTD. And, of course, we don't know when the economy will improve, given geopolitical issues, inflation and interest rate hikes.

Nevertheless, we are positive on the sector, given three factors: **1)** a potential recovery in margins, **2)** global expansion in content (especially webtoons), and **3)** trough valuations.

Exhibit 11: Share price performance YTD

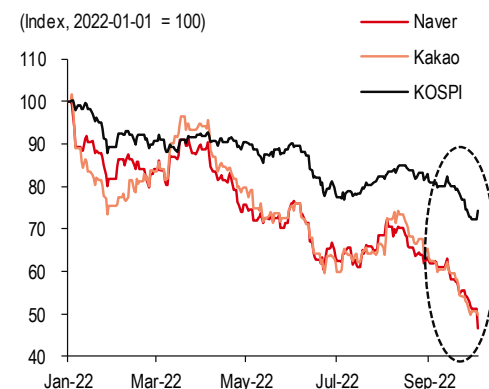
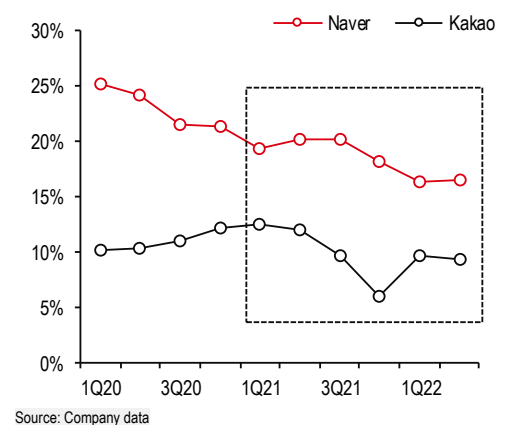


Exhibit 12: Naver and Kakao – Operating margins continue to drop



Why do we expect a potential margin pick-up?

The reason we have a positive view on margins for the Korean internet sector is the possibility of a sales growth recovery in high-margin businesses: advertisement and e-commerce.

◆ **Advertisement: We expect Naver and Kakao to beat market growth**

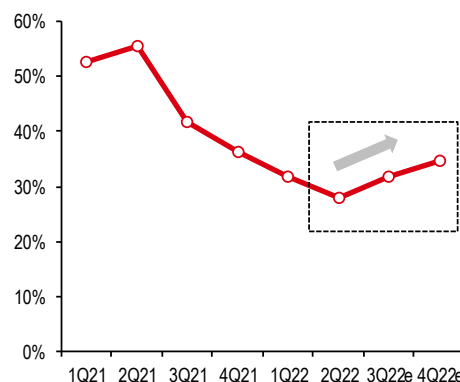
- Focusing on long-tail advertisers and ad inventory expansion is key

One of main reasons why Naver and Kakao have seen a margin contraction in the past few years was the slowdown in growth in advertisement sales as advertisers cut their budgets, given the economic downturn. In particular, as they had focused on Display Ads (DAs), which target the general public, that large corporates usually use, the negative impact of the budget cuts was significant for Korean internet platforms.

However, Korean internet platforms are now focusing on so-called long-tail or niche advertisers by strengthening Search Ads (SAs) that target specific customers and are typically less sensitive to the economic environment. We believe this strategy can offset the negative impact from the budget cuts at large advertisers.

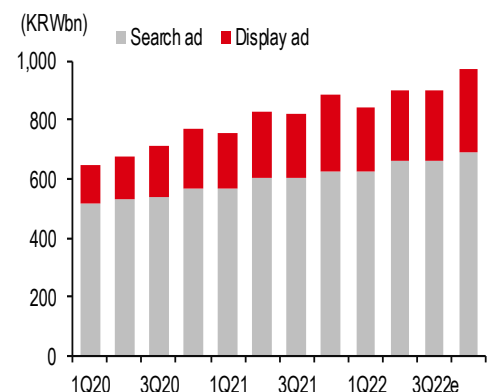
In addition, the strategy to raise the video ad portion will help Naver and Kakao deliver better growth than the overall ad market, in our view. In particular, we are encouraged by Kakao's plan for its ad inventory expansion. It plans to introduce SAs in the open chat space – chat rooms for conversations with strangers (see Exhibit 20) – which is now recording 9m daily average users (DAU), according to the company, starting from 4Q22e. And, according to reports (New1, 16 September 2022), Kakao is now testing ads in some rooms of the open chat space. We forecast Kakao's Talk Biz (its main business that houses the Kakao Talk platform) advertisement sales growth in 2023e to maintain a solid clip of over 20%. We also have a positive view on Naver, despite relatively fewer changes to its strategy compared to Kakao. The two companies already have a high exposure to SAs, which made up 73% of total ad sales as of 2Q22. So, if both companies successfully offset the negative impact from budget cuts by large advertisers with their strategies, we believe this can lead to a potential margin pick-up in the future. This means both Naver and Kakao can continue to outperform the overall domestic ad market growth in the next 2-3 years.

Exhibit 13: Kakao – Talk Biz advertisement y-o-y sales growth to rebound in 2H22e

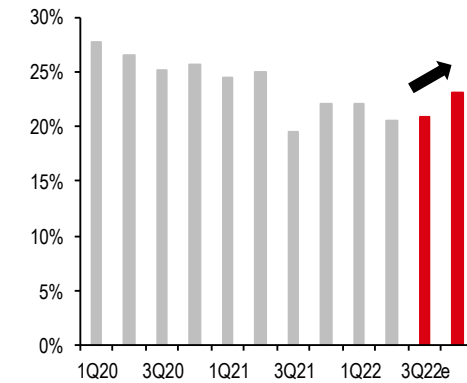


Source: Company data, HSBC estimates

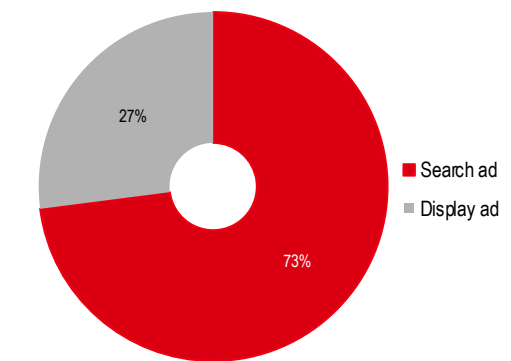
Exhibit 14: Naver – Quarterly ad sales trend; Search Ads are performing well



Source: Company data, HSBC estimates

Exhibit 15: Kakao – Sales contribution trend for the overall advertisement business


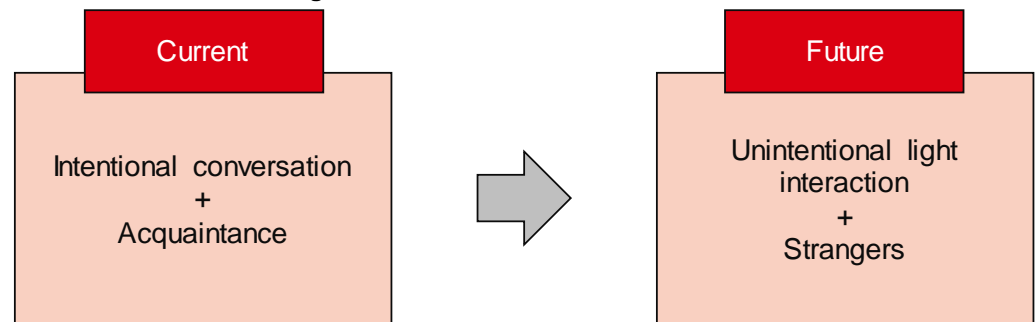
Source: Company data, HSBC estimates

Exhibit 16: Naver – Ad sales breakdown by type (as of 2Q22)


Source: Company data, HSBC estimates

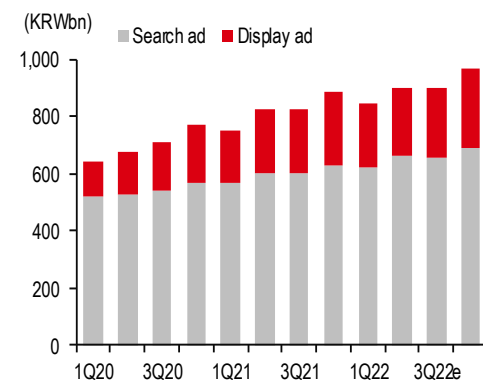
- Strategy details

i) Kakao (035720 KS): Management is trying to expand its ad inventory by introducing search ads and video ads in the open chat space. It plans to launch the open chat space as a separate application by focusing on enabling users to chat with people they don't know in various themed open chat rooms. For example, a user could create an open chat room like 'A chat room for BTS fans' that would allow other users to enter the room and they could then all chat together. Kakao then plans to introduce advertisements in these chat rooms. This is unlike the original Kakao Talk app, which focuses on conversations with acquaintances. Considering that 9m DAU are now using the open chat space, according to the company, we expect significant growth in Talk Biz advertisement. In particular, as users with similar interests gather together in open chat rooms, we expect solid demand from advertisers that want to spend their budget efficiently by targeting specific customers. Long-tail advertisers usually use search advertisements, and we expect this can offset the negative impact of the budget cuts by large advertisers. So, we believe Talk Biz sales growth can rebound to 26% in 2023e from 21% in 2022e thanks to the impact of the full launch of SAs, which are scheduled to be launched in 4Q22 in the open chat space. Moreover, we also expect a potential recovery in DAs with the introduction of video ads, which have higher average selling prices (ASPs) than non-video ads. Although there is a risk that users will exit Kakao Talk, given that they will likely be exposed to more ads in the future, we have yet to see a drop in the number of monthly average users (MAU) at Kakao Talk. Of note, Kakao Talk's MAU were 47.5m and 5.8m in Korea and in the overseas market, respectively, in 2Q22. In addition, with the company planning to make changes to the 'Friends' tab on the Kakao Talk platform, we expect there to be synergies for the ad business.

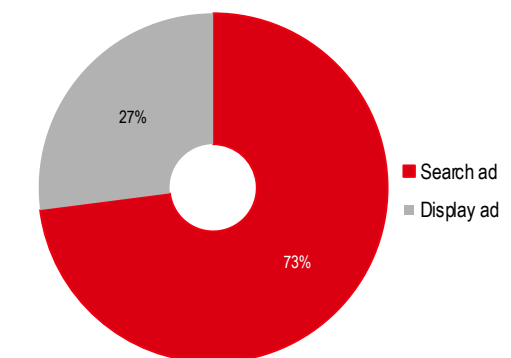
Exhibit 17: Kakao – Strategic direction


Source: Company data, HSBC

ii) Naver (035420 KS): The company already has high exposure to SAs as these accounted for 73% of its total search platform sales as of 2Q22. So, the negative impact of the budget cuts from large advertisers is relatively muted for Naver. High-margin SAs are more insulated from the economic downturn, given the long-tail customer base. Despite advertisers tightening marketing budgets, SAs revenue grew 10% y-o-y in 2Q22, above pre-pandemic levels.

Exhibit 18: Naver – Has always been good at Search Ads


Source: Company data, HSBC estimates

Exhibit 19: Naver – Ad sales breakdown by type (as of 2Q22)


Source: Company data

- When will the ad market recover? We need to track advertisers' sentiment

For the overall domestic advertisement market, Cheil Worldwide (030000 KS, KRW22,750, Not Rated), one of Korea's largest advertisement companies, has announced domestic advertisement expenditure early every year since 1973. According to the company, total ad expenditure y-o-y growth will likely slow to 9% in 2022 from 20% in 2021. Korea Broadcast Advertising Corporation (KOBACO) also publishes annual ad expenditure reports and, according to 'Korea Advertising Expenditure Research', which was published in December 2021, total ad expenditure y-o-y growth will drop to c14% in 2022 from c17% in 2021. The exact forecasts are slightly different between Cheil Worldwide and KOBACO; however, the broad picture is the same as overall ad expenditure will likely slow in 2022e compared to 2021, in our view. This was one of major reasons for the deterioration in investor sentiment.

Exhibit 20: Cheil Worldwide – Domestic advertising growth forecast to slow

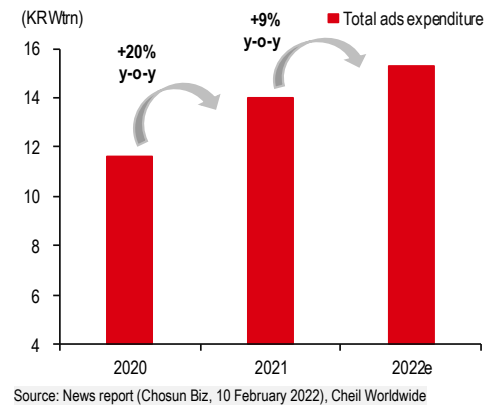
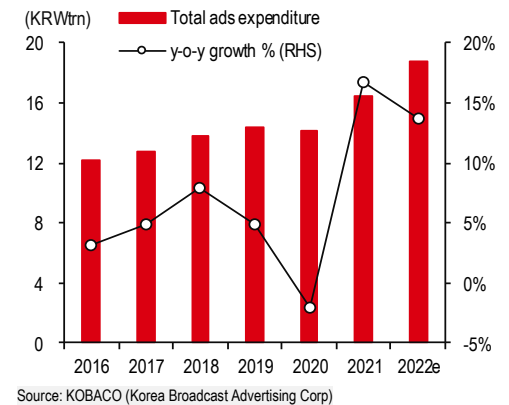


Exhibit 21: KOBACO – Expects a slowdown in the growth of total ad expenditure in 2022e



However, interestingly, we found that KOBACO's monthly Korea Advertising Index (KAI) continues to be above the 100 level, which means that advertisers expect higher expenditure in the next month compared to the prior month. So, once there are signs of an economic recovery, we expect the domestic advertisement market to recover its strong growth rate, similar to 2021.

Exhibit 22: Monthly forecast KAI

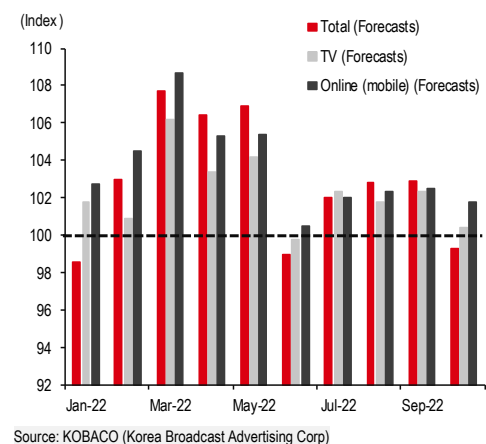
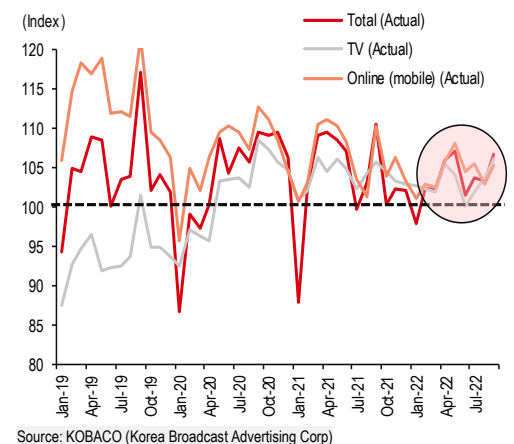


Exhibit 23: Monthly actual KAI

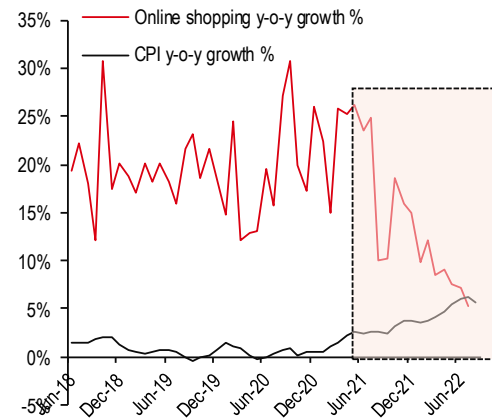


◆ **We also see a potential recovery in e-commerce**

- Unfavourable macro environment continues

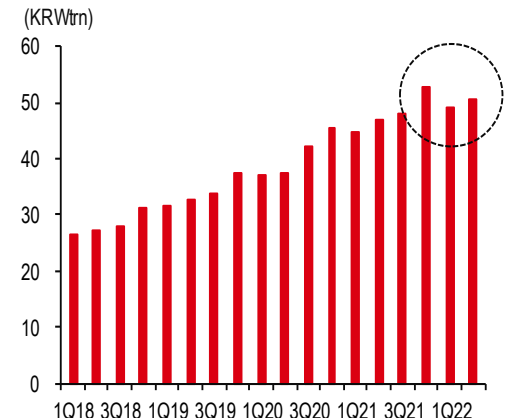
Due to the ongoing macro environment uncertainties, GMV growth for the Korean online shopping market has slowed, starting from early 2022. With the increase in outdoor activities after the pandemic, interest rate hikes and inflation, customers are choosing not to spend money on non-essentials. According to Statistics Korea, the online shopping GMV y-o-y growth was down to 5% in July 2022 from 19%, the average y-o-y growth in 2021.

Exhibit 24: CPI increase is negative for the recovery of online shopping growth



Source: Statistics Korea

Exhibit 25: Quarterly online shopping transaction value trend



Source: Statistics Korea

Exhibit 26: Korea's retail and online shopping GMV estimates; decelerating online shopping GMV growth in 2022e but recovering again in 2023e

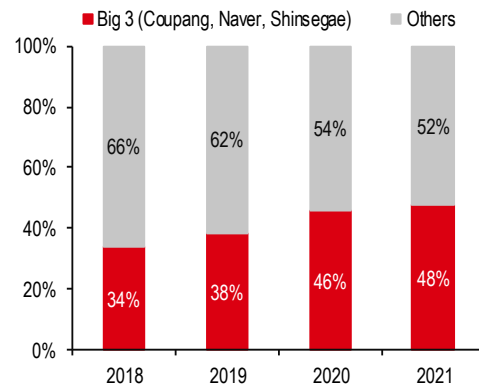
(KRWbn)	2020a	2021a	2022e	2023e	2024e	2025e	2026e	2027e
Korea retail GMV (KRWbn)	475,180	514,487	551,526	590,127	635,061	683,417	735,454	791,454
% q-o-q	-	-	-	-	-	-	-	-
% y-o-y	0%	8%	7%	7%	8%	8%	8%	8%
Korea online shopping GMV (KRWbn)	161,670	192,472	206,311	229,487	257,271	287,798	321,443	358,550
% q-o-q	-	-	-	-	-	-	-	-
% y-o-y	20%	19%	7%	11%	12%	12%	12%	12%
% e-commerce penetration rate	34%	37%	37%	39%	41%	42%	44%	45%
Korea offline GMV (KRWbn)	313,510	322,015	345,215	360,640	377,791	395,619	414,011	432,904
% q-o-q	-	-	-	-	-	-	-	-
% y-o-y	-7%	3%	7%	4%	5%	5%	5%	5%

Source: Statistics Korea, HSBC estimates

- However, the current period can be an opportunity for top-tier companies

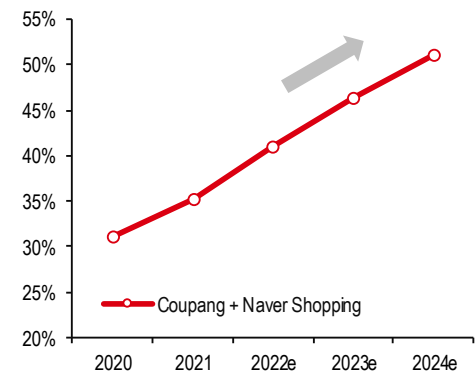
However, like what we emphasise in our Coupang initiation report ([Initiate at Buy: Ready to become the market leader](#), 6 October 2022), we believe the current period is an opportunity for top-tier companies. Based on the 2021 GMV, the top three companies in the domestic e-commerce market were Naver and Coupang, followed by Shinsegae Group (004170 KS, KRW230,000, Buy), which owns G Market Global (Unlisted) and SSG.com (Unlisted), two e-commerce companies in Korea. The three companies' combined GMV market share has expanded to 48% in 2021 from 34% in 2018. In particular, the market share expansion of the top two companies – Naver and Coupang – was significant as it jumped to a combined 36% in 2021 from 19% in 2018. We expect this trend to continue and the combined market share will likely exceed 40% in 2022e thanks to: 1) potential market consolidation and 2) strengthening user loyalty.

Exhibit 27: Top three companies' market shares have expanded...



Source: Various news reports, Company data. Note Shinsegae (004170 KS, KRW230,000, Buy)

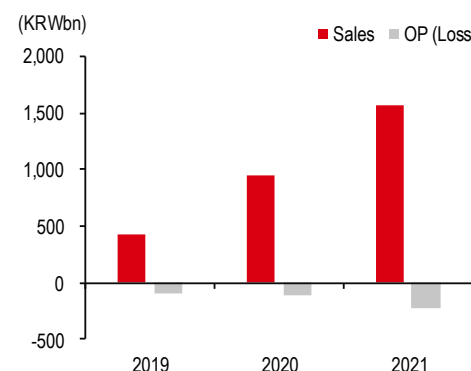
Exhibit 28: ...especially Coupang and Naver, which are leading the local market



Note: The numbers are the combined market share.
Source: Various news reports, Company data

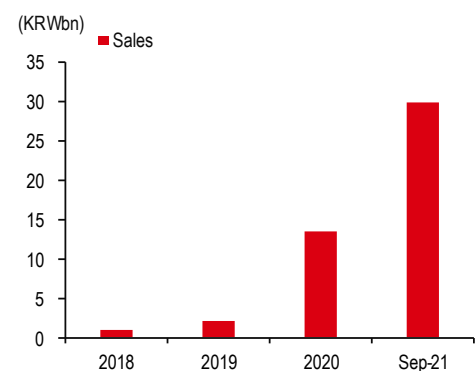
i) Potential market consolidation: One of the reasons why we may see market share expansion at the top-tier companies is potential market consolidation. As the online shopping GMV growth has slowed starting from early 2022, small- to medium-sized e-commerce companies, which emerged during the pandemic, started to suspend their services or exit the market. According to news reports (E-daily, 5 September 2022), Onul-hoi, an online goods delivery platform that delivers fresh fish and has 800,000 customers, recently suspended its service, given fast-growing cost pressures. A similar picture is emerging for companies providing “dawn” delivery services of fresh food. According to news reports (Herald, 24 August 2022), Lotte Shopping (023530 KS, KRW91,100, Hold) halted its “dawn” delivery service, which was conducted via Lotte On, in April 2022, while BGF Retail (282330 KS, KRW164,000, Buy) stopped in May 2022, and Fresheasy (Unlisted) and GS Retail (007070 KS, KRW25,400, Buy) followed in July 2022. We expect to see a similar picture for the overall e-commerce market, which is positive for the large platform operators. In Exhibit 30, we show recent M&A transactions in the domestic market.

Exhibit 29: Market Kurly – Despite fast top-line growth, operating losses have grown



Source: Company data, News reports (e.g. Money S, 24 August 2022)

Exhibit 30: Onul-hoi – Showed rapid sales growth, but it recently halted its service



Source: News reports (e.g. E-daily, 5 September 2022), HSBC

Exhibit 31: Recent M&A transactions in the domestic e-commerce market

Company	Details
T-Mon	Acquired by 'Qoo10', an e-commerce company in Singapore specialised in overseas direct purchases
Danawa	Merged with 'Korea Center', an operator of an overseas direct purchase and price comparison services platform
Interpark	Acquired by 'Yanolja', an accommodation and leisure platform
G-market	Acquired by E-Mart (139480 KS, KRW83,900, Buy) in the Shinsegae Group (004170 KS, KRW230,000, Buy)

Source: Various news reports (e.g. Munhwa, 5 September 2022), HSBC. Note: Closing price as of 4 October 2022.

ii) Strengthening user loyalty: Another key reason why we may see market share expansion at the top-tier companies is growing user loyalty. In the domestic e-commerce market, there is a limit to the number of online shoppers, based on the country's population. Therefore, it is important for e-commerce companies to acquire many loyal customers. To do this, they have launched their own paid membership programmes to raise the loyalty of their customers. As a result, competition for membership benefits has intensified. For example, Naver provides benefits related to its content businesses like Naver Webtoon and Naver Series to its paid membership users. The users can use Naver's various services for free by only subscribing to a Naver Plus Membership. Coupang provides Coupang Play, a video streaming service, which was launched in 2020, for free to Coupang Wow subscribers. However, these benefits incur considerable costs for the e-commerce companies. As such, it makes it more difficult for small- and medium-sized companies that have weaker balance sheets. We expect large corporates will try to acquire various smaller companies to stay competitive, with the consequence being that the smaller companies, which are not acquired, will likely "disappear".

In particular, we see the importance of loyal customers by analysing user data from Coupang in Exhibit 32. As time goes by, users spend more money and new users' first-year GMV grows. In a nutshell, despite slowing e-commerce market GMV growth, top-tier companies like Naver and Coupang can show higher growth than their peers.

Exhibit 32: Coupang – Cohort data; as time passes, customers spend more money on Coupang due to strengthened loyalty

	Year 1	Year 2	Year 3	Year 4	Year 5
2017 Cohort	1.00x	1.80x	2.35x	3.46x	4.55x
2018 Cohort	1.00x	1.98x	3.06x	4.17x	
2019 Cohort	1.00x	2.19x	3.11x		
2020 Cohort	1.00x	1.94x			
2021 Cohort	1.00x				

Source: Company data (Coupang)

Exhibit 33: Newer cohorts spend: starting higher, growing faster

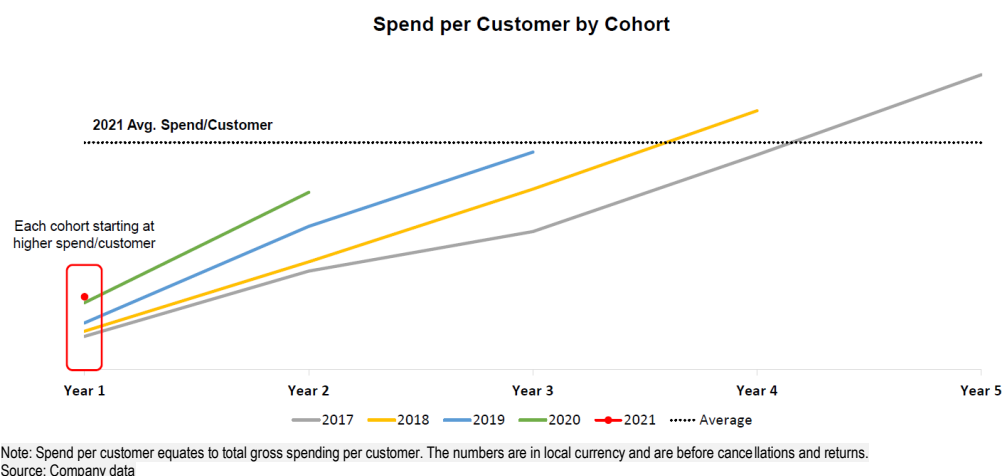


Exhibit 34: Major e-commerce companies in Korea launched their own membership to keep customers loyal

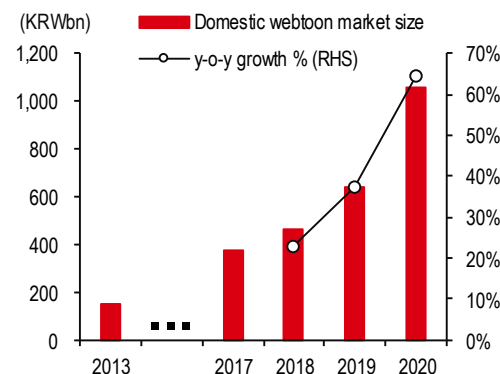
	Naver	Coupang	SSG.COM	Gmarket Global	Lotte On
GMV (as of 2021) (KRWtrn)	32	38	6	17	3
Market share for GMV (as of 2021)	17%	20%	3%	9%	2%
Membership	Naver Plus Membership	Coupang Now	Smile Club (integrated membership with Gmarket Global)	Smile Club (integrated membership with Gmarket Global)	Lotte Owners
Membership launch date	June 2020	2019	May 2022	May 2022	July 2019
Price	KRW4,900 per month	KRW4,990 per month	KRW3,900 per month	KRW3,900 per month	KRW2,900 per month KRW20,000 per year
# of subscribers	8m (as of February 2022)	9m (as of 1Q22)			
Key benefits	1) Provides additional Naver Pay points 2) Subscribers can share the membership with three additional family members 3) Subscribers can choose one digital content benefit among six choices (TVING, SPOTVE Now, Webtoon, Naver Series, VIBE and cloud service)	1) Free delivery 2) "Dawn" delivery and same-day delivery 3) Additional discount for Wow members 4) Free take back 5) Coupang Play	1) Free delivery and "dawn" delivery when the payment is over KRW15,000 2) Provides additional points 3) Free size upgrade at Starbucks	1) Free delivery when the payment is over KRW15,000 2) Provides four types of discount coupons per month 3) Provides additional Smile Cash	1) Provides 20,000 Lotte Points that users can use instead of cash on Lotte Group's online shopping platforms for annual membership users 2) Membership is applied to Lotte's six shopping malls (Lotte On, Lotte Department Store, Lotte Mart, HI-Mart, Lotte Home Shopping and Lotte Fresh) 3) Free delivery in each shopping mall twice per month 4) Additional discounts and points

Source: Company data, Various news reports (e.g. ET News, 28 June 2022)

Upside from the webtoons business

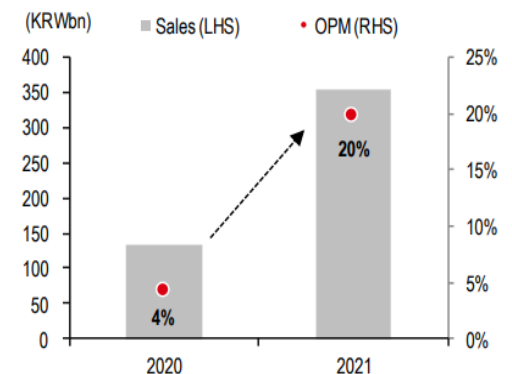
Webtoons – Korean cartoons on the web – are one of the major businesses that Naver and Kakao consider as their future growth drivers. They were originally known as “Online Cartoons” in the early 2000s but have since been rebranded to webtoons and surged in popularity amid the spread of smartphones in the mid-2010s. According to Korea Creative Contents Agency (KOCCA), the domestic webtoons market size is over KRW1trn (up 65% y-o-y) in 2020. Based on high GMV growth, the profitability of Korean webtoon operators has also improved. For example, Naver Webtoon (Korea) saw its OP margin improve to 20% in 2021 from only 4% in 2020. Although Kakao doesn’t disclose margin details, it is also recording positive margins in its domestic webtoon business, according to the company. According to Open Survey, among webtoon users in Korea, 70% have spent money on webtoons. In addition, considering that Naver Webtoon’s paying ratio in Korea was about 26% in 2Q22, there is still more room for upside in GMV in the domestic market, in our view. And, although user traffic is slowing as social distancing rules are relaxed and inflation erodes consumer purchasing power, we expect 2023e top-line growth in the content business to be solid at Naver and Kakao with ongoing global business expansion.

Exhibit 35: Annual domestic webtoon market size



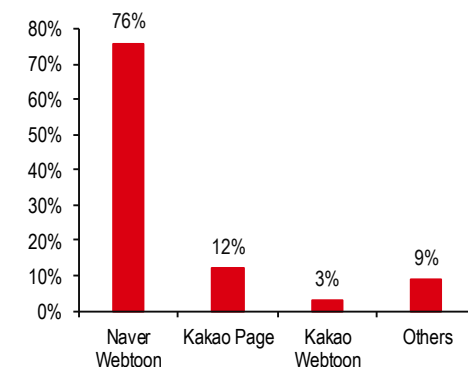
Source: KOCCA (Korea Creative Contents Agency)

Exhibit 36: Naver Webtoon (Korea) – Margin expanded substantially in 2021 with top-line growth



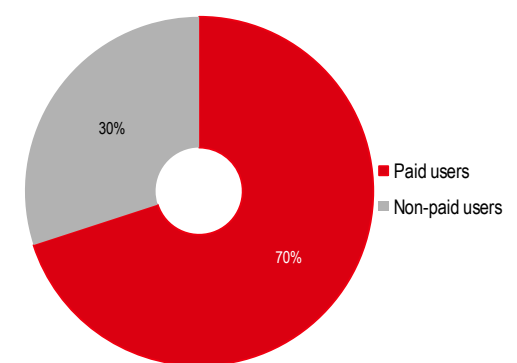
Source: Company data

Exhibit 37: Market shares of the domestic webtoon market



Source: News report (e.g. Asia Economy, 28 July 2022), Open Survey

Exhibit 38: According to Open Survey, about 70% of webtoon users have spent money on webtoons (as of July 2022)

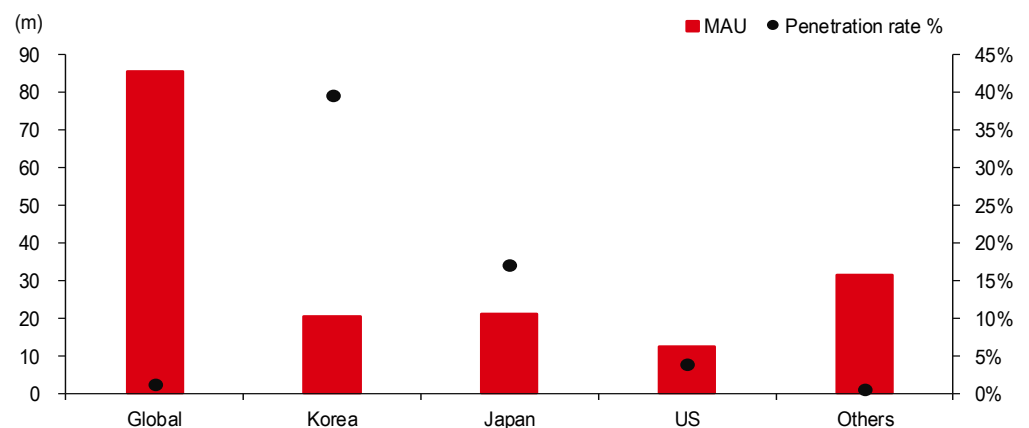


Source: News report (e.g. Asia Economy, 28 July 2022), Open Survey

◆ **Global webtoon market is an untapped opportunity**

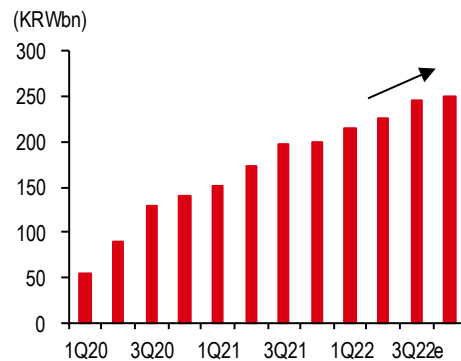
While Korea is the home of the webtoon industry, companies are starting to venture abroad. The industry remains fairly niche outside the country, though webtoons are very much part of the “Korean wave” of cultural exports. If we roughly calculate the webtoon penetration rate by region based on Naver Webtoon’s MAU and the number of people, the rates in overseas markets, except Japan, are low, which means it is still at the early stage of the webtoon market overseas expansion. In Korea, the penetration rate is about 40%. So, once Naver and Kakao successfully expand their webtoon businesses in overseas markets, we believe there will likely be significant GMV growth that can lead to overall top-line growth in the future and this is why they focus on global expansion.

Exhibit 39: The global webtoon market is in an initial growth stage

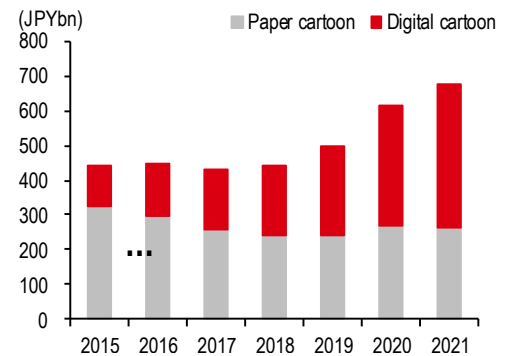


Note: Numbers can be different from actual data as the numbers are based on HSBC calculations using Naver’s Webtoon MAU (as of 2Q22) and population. Penetration rate is calculated by dividing Naver’s Webtoon MAU by the total population.
 Source: Company data, Statistics Korea, HSBC

Korean internet companies first took their webtoons to Japan. Kakao Piccoma, Kakao’s webtoon platform operating subsidiary in Japan (previously known as Kakao Japan), launched in the country in April 2016 with its GMV growing for 25 consecutive quarters and its MAU exceeding 9.5m with a GMV of about KRW77bn in 2Q22. The key strategy of Piccoma was providing various content by: 1) digitalising the popular paper-based cartoons provided by leading Japanese publishers, and 2) on-boarding Kakao Entertainment’s webtoons, which created success in the Korean market. For Naver, it already had Line Manga, a webtoon platform operated by Line Frontier, a subsidiary in Japan, for its service in Japan, and it then acquired e-Book Japan, a web novel platform in Japan, in March 22, the combined GMV on the two platforms exceeded KRW96bn, a record-high GMV. Considering that Naver reported a 2Q22 webtoon GMV of KRW220bn in Japan, the monthly GMV in 2Q22 was about KRW73bn. This means that there was about 30% q-o-q growth in GMV in Japan. In addition, as the digital cartoon market continues to grow in Japan, Naver and Kakao may enjoy GMV growth in the future based on their combined dominant market share, in our view.

Exhibit 40: Kakao Piccoma – Quarterly GMV trend


Source: Company data

Exhibit 41: Japan's cartoon market size trend; growing digital cartoon portion


Source: AJPEA (The All Japan Magazine and Book Publisher's and Editor's Association)

Although Kakao and Naver are still recording operating losses in overseas markets due to high marketing costs, we expect margins in the global business to turn positive once GMV grows fast. In particular, as webtoons become more popular globally, the content can be used to produce videos amid intensifying competition among global video streaming platforms. For example, Sweet Home, D.P. and HELLBOUND on Netflix (NFLX US, USD240.74, Not Rated) are all based on webtoon content. So, Naver and Kakao are strengthening their respective webtoon business globally not only for GMV growth but also to acquire original content that can be used in the video content production business.

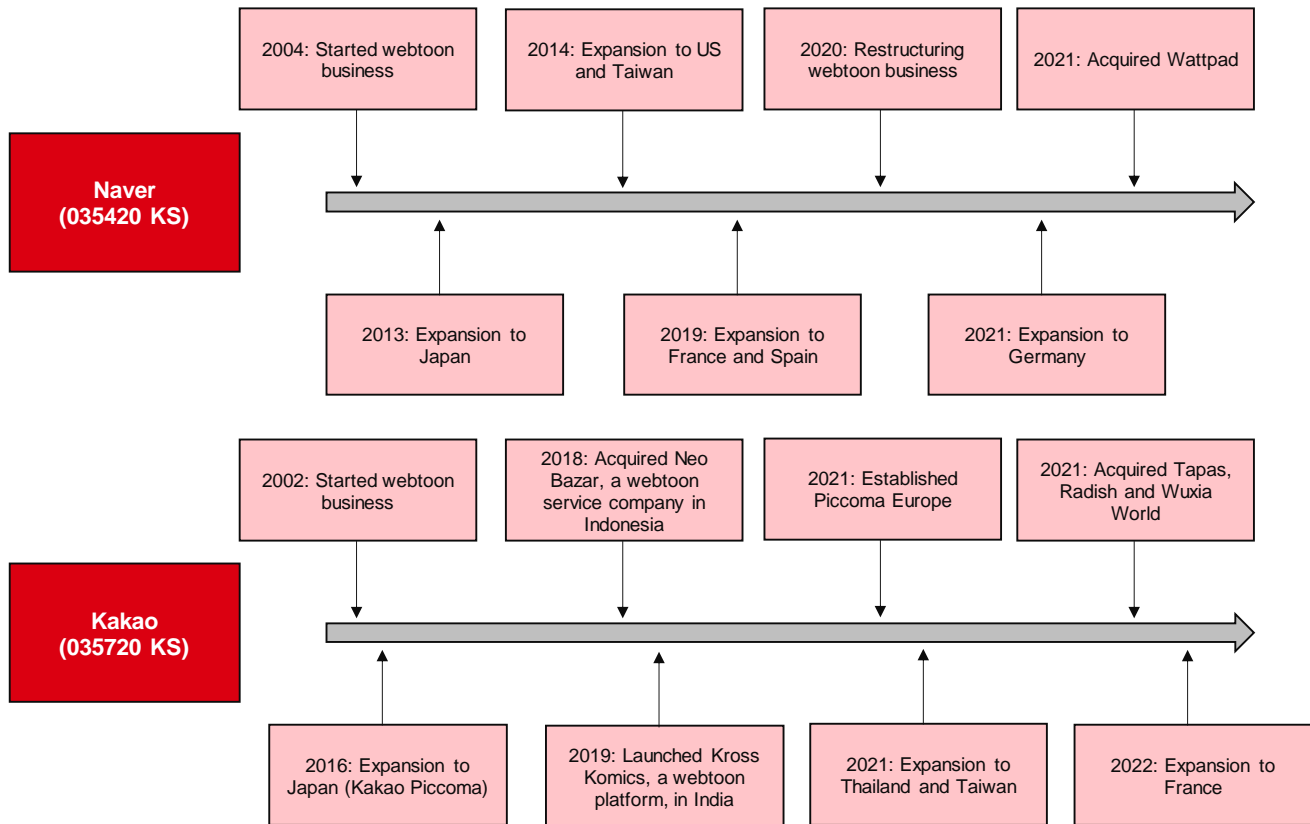
Exhibit 42: Examples of video content based on webtoons

Date	Contents	Platform (OTT)	Webtoon based
December 2020	Sweet Home	Netflix	Naver Webtoon
March 2021	Navillera	tvN	Kakao Webtoon
August 2021	D.P.	Netflix	Lezhin Comics
November 21	Dr. Brain	Apple TV+	Kakao Webtoon
November 2021	HELLBOUND	Netflix	Naver Webtoon
January 2022	Dr. Park's Clinic	TVing	Naver Webtoon
January 2022	All of Us are Dead	Netflix	Naver Webtoon

Source: Company data, HSBC

Both Naver and Kakao started to expand their respective webtoon business globally from the 2010s. Starting in Japan, they have since expanded to Southeast Asia, North America and Europe. In particular, they began to strengthen their respective business in the US in earnest from 2021 through various acquisitions. Recently, they also started to strengthen their respective business in Europe by each establishing a local corporation. Naver first started its webtoon service in France in December 2019 and plans to establish Webtoon EU in 2H22 to operate its European business more efficiently. For Kakao, Tapas Media and Raddish Media, which it acquired to strengthen its global webtoon business in 2021, were integrated and restructured as Tapas Entertainment in 3Q22 with plans to develop global new content and expand webtoons produced in Korea globally. Kakao also established Piccoma Europe in September 2021 and started operations in France from March 2022.

Exhibit 43: Naver and Kakao have expanded their respective webtoon business globally



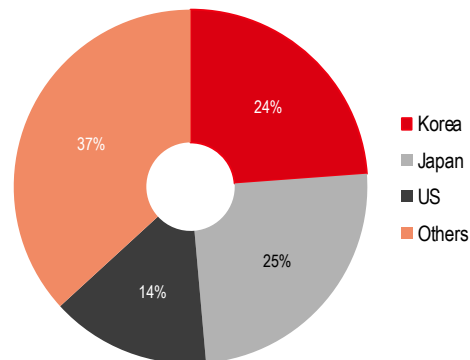
Source: Company data, HSBC

◆ **What can turn around the margins at the global webtoon business?**

Naver and Kakao spent more than 10 years trying to generate a profit at home after the spread of smartphones. We believe profits at their respective overseas business can come sooner. Why? We are optimistic on the webtoon business in Japan, the US and Europe for three main reasons: **1)** higher ARPPU than in Korea, **2)** strong potential upside in the paying ratio with a still low penetration rate, and **3)** a higher revenue per GMV rate (which is a proxy of the take rate). In the past, although Naver and Kakao have talked about the global webtoon market, investors couldn't fully understand the vision or the path to profitability and had concerns about cost pressures, given aggressive marketing activities and a lack of data. However, we think this is changing after Naver disclosed details of key performance indicators (KPIs) related to webtoons in its 2Q22 result conference call. We see good reasons for Korean internet companies' aggressive overseas marketing for webtoons.

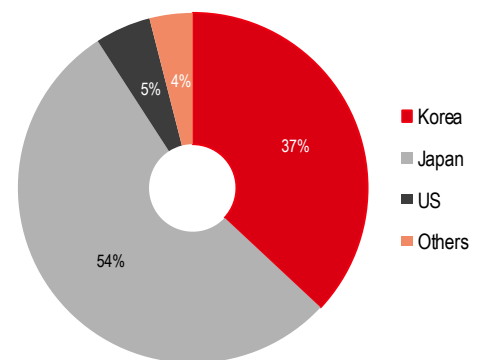
If we look at Naver's data, its ARPPU in the US and Japan was KRW13k and KRW35k, respectively, while in Korea it was only KRW9k. However, the paying ratios in the two countries are still low, at below 10% (vs. 26% in Korea). We see potential upside for these paying ratios and a higher penetration rate in the future. According to the Webtoon Trend Report 2022 by Open Survey, the penetration ratio of webtoons in France, the second-largest cartoon consumption country after Japan, is only 2-3% currently. Although it seems like the webtoon penetration is still low globally, despite the aggressive marketing by Korean internet companies, webtoons is a market that Korean internet companies have created. In a nutshell, we see the possibility that margins in Japan, the US and Europe can improve to a similar level as those in Korea in the medium to long term, if the paying ratio can successfully increase. If this happens, we believe Naver and Kakao can achieve an overall margin expansion in the future.

Exhibit 44: Naver Webtoon – MAU breakdown by region (as of 2Q22)



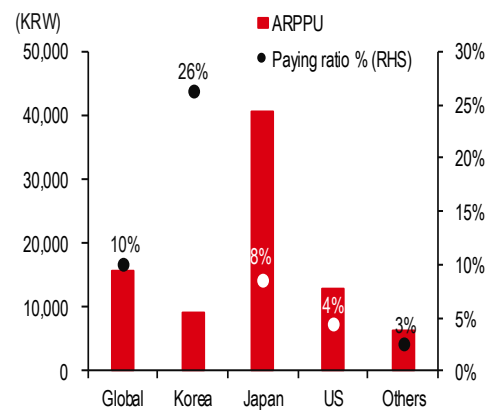
Source: Company data

Exhibit 45: Naver Webtoon – GMV breakdown by region (as of 2Q22)



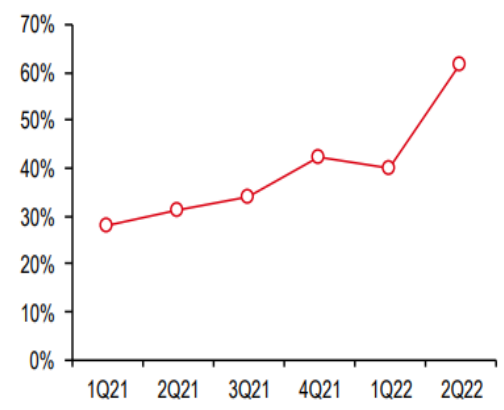
Source: Company data

Exhibit 46: Naver Webtoon – Paying ratio and ARPPU by region; significant revenue opportunities in the US and Japan



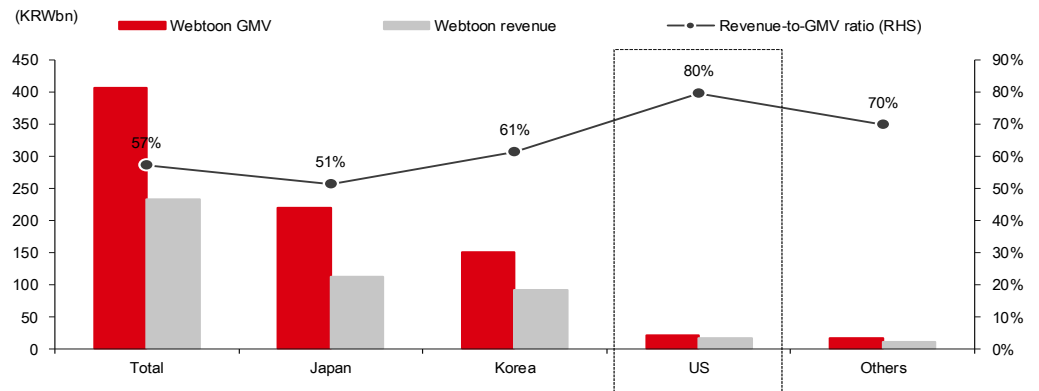
Source: Company data. Note: As of 2Q22

Exhibit 47: Naver – Webtoon quarterly revenue-to-GMV ratio



Source: Company data

Exhibit 48: Naver Webtoon – Strong upside potential of the US webtoon business with a much higher take rate and with a still low GMV contribution



Source: Company data

Exhibit 49: Naver Webtoon – Operating profit by region (as of 2Q22); still generating losses in overseas markets, but we see potential upside from a margin pick-up when the company successfully acquires users and raises the paying user portion

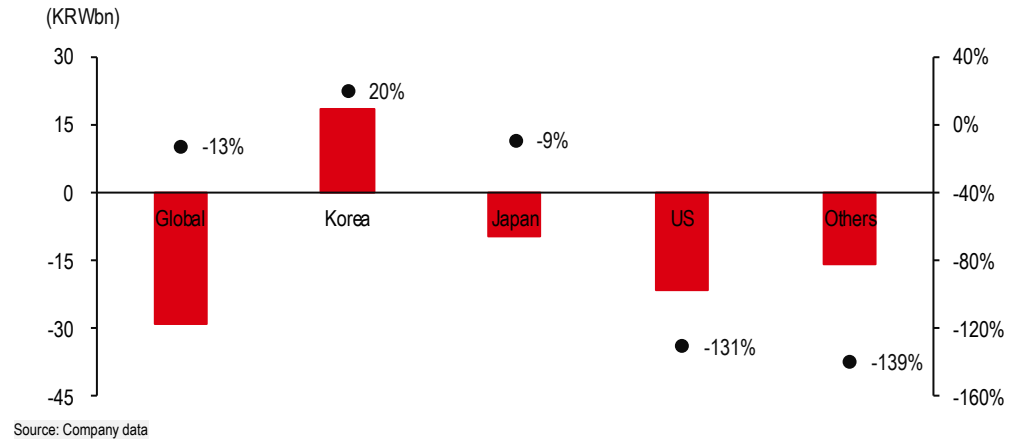


Exhibit 50: Naver Webtoon – Quarterly global GMV trend

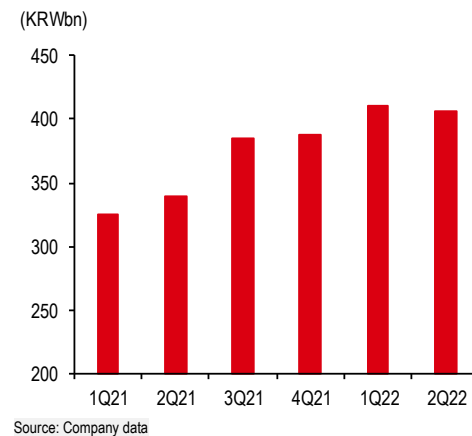


Exhibit 51: Kakao – Annual platform GMV trend related to the Story business (a revenue segment related to webtoons)

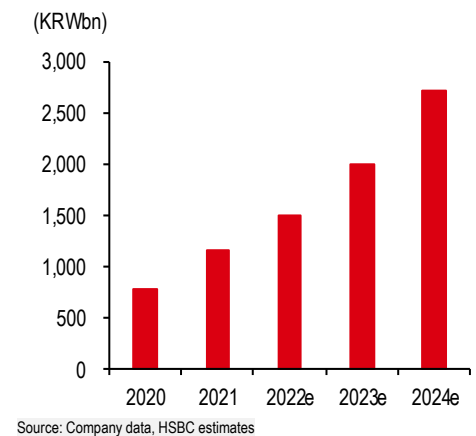


Exhibit 52: Naver – Quarterly content revenue trend

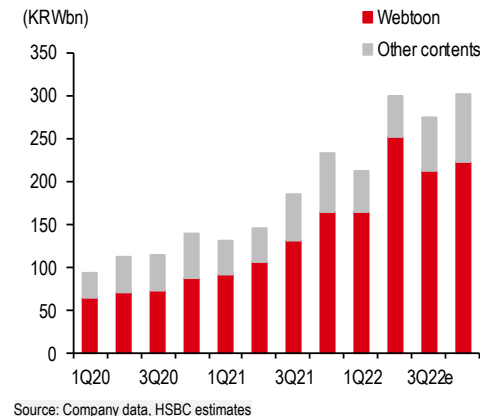
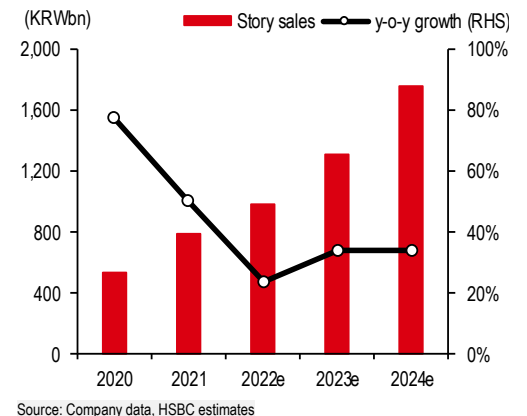


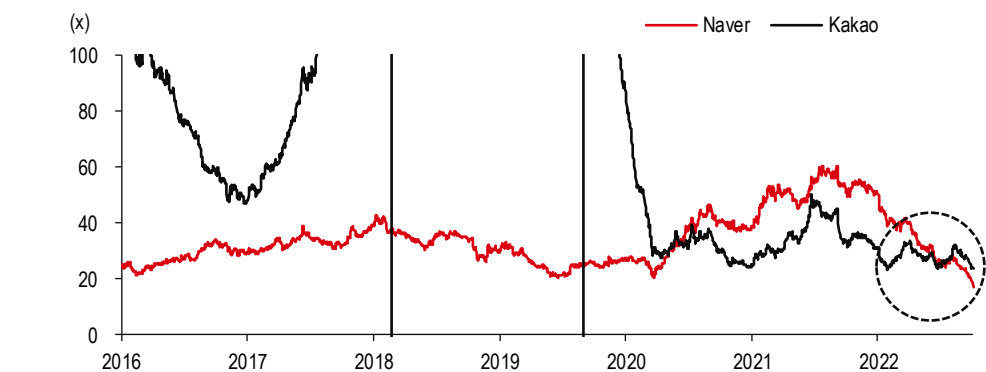
Exhibit 53: Kakao – Annual Story sales and y-o-y growth estimates



Tough environment, but we think we have hit the trough

As we have mentioned above, the share prices of Naver and Kakao have fallen since September 2021. Given the range of macro uncertainties, we believe it will be hard to restore investor confidence. However, both companies reported better-than-expected results in the 1H22, despite the market's concerns about slowing revenue growth in their respective major business segments. In addition, as we see signs that their major businesses are bottoming and of a potential margin pick-up in the global webtoon business, we believe the share prices can recover once there is some positive news around future growth drivers. In particular, as Naver and Kakao are currently trading at a 2023e PE multiple of 17x and 29x, respectively, we believe the negatives are well flagged. That is why we have a positive view on the Korean internet sector. For Kakao, the parent value is now trading at a 9x PE multiple.

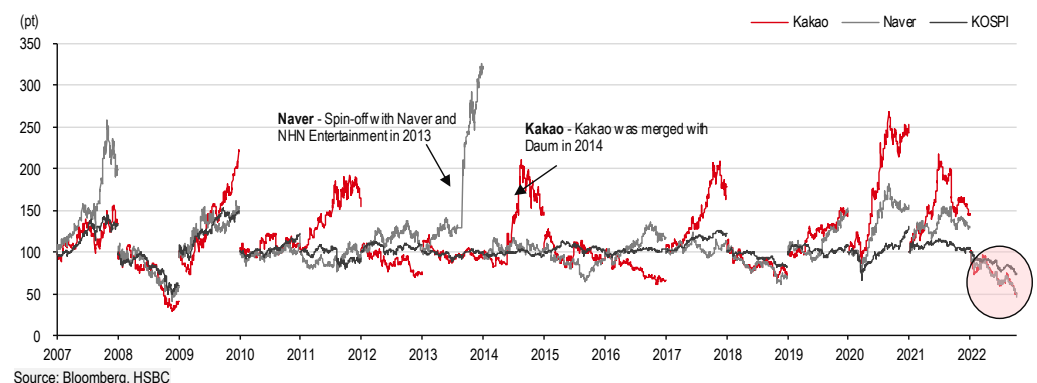
Exhibit 54: Naver and Kakao – 12-month forward PE trend



Source: Company data, Bloomberg, HSBC estimates

Interestingly, if we look at the historical YTD share price performance of Korean internet companies for the past five years, the Korean internet sector outperformed in four out of five years. In particular, it is now experiencing one of the so far toughest years in 2022.

Exhibit 55: The Korean internet sector has been under pressure so far this year



Source: Bloomberg, HSBC

Where can we be wrong?

Unlike in 2020-21, the annual sales growth at Korean internet companies has slowed due to the challenging macro environment impacting their core business of advertising and e-commerce. If the economy doesn't improve and there are no significant structural changes in the market, it is difficult to expect a growth rate recovery. Nevertheless, the reason why we have a positive view on the sector is the improved profitability. We believe Naver and Kakao can show OP margin expansion starting from 2H22e. However, if the margin doesn't rebound like we expect, the share prices may remain under pressure or face additional de-rating. Key obstacles for OP margin improvement are: **1)** a lower-than-expected positive impact from SAs to offset the budget cuts by the large advertisers, **2)** competition intensifies in e-commerce without market consolidation, and **3)** higher-than-expected marketing costs for global businesses, especially webtoons.

As our key focus is a margin recovery amid slowing top-line growth, any obstacles that interrupt the margin rebound are negative for Naver and Kakao. For Kakao, one key development to watch is the possibility of changing the fee income related to Talk Gift refunds. Currently, if users want to refund their Talk Gifts that they have received from other users, they can get 90% of the total transaction value while Kakao gets a 10% fee. According to news reports (Maekyung, 20 September 2022), Kakao is now considering not to take any refund fee related to Talk Gifts, a move that would negatively affect its margins. However, given the refund fee income was only KRW33bn in 2021, about 5% of 2021 OP, the impact will likely be limited. We also consider the positive impact for GMV growth, if this plan is executed. We don't reflect this in our earnings estimates because we don't know whether it will go ahead at this point and this potential plan can also change. For Naver, after it announced the acquisition of fashion re-commerce platform PoshMark (POSH US, USD17.61, Not Rated) on 4 October, the market reacted negatively and the share price fell c9% mainly on concerns about the possibility of a negative impact on the margin side amid the ongoing margin contraction. Nevertheless, the negative impact will likely be limited, given that the portion of PoshMark's 1H22 operating loss of Naver's OP in 1H22 is below 10%. In addition, we believe the concerns are overdone as Naver may achieve an improvement in PoshMark's profitability through the competitiveness of its various commerce-related merchant solutions.

Exhibit 56: Global peer comparison table

Company	Ticker	Rating	Target Price (LCY)	Price (LCY)	Mkt Cap (USDm)	PS (x)		OPM (%)		PE (x)		PB (x)		ROE (%)	
						2022e	2023e	2022e	2023e	2022e	2023e	2022e	2023e	2022e	2023e
Naver	035420 KS	Buy	270,000	176,500	18,416	3.5	2.9	17%	18%	25.9	17.5	1.2	1.1	5%	6%
Kakao	035720 KS	Buy	91,000	55,900	16,984	3.4	2.7	10%	12%	15.3	29.1	2.2	2.0	15%	7%
Coupang	CPNG US	Buy	27.80	20	34,526	1.7	1.5	-4%	0%	NM 2,179.9		20.0	17.2	-39%	1%
Big Tech															
Alphabet	GOOGL US	NR	-	102	1,331	5.2	5.0	32%	34%	18.1	15.8	4.8	4.2	26%	26%
Meta Platform	META US	Hold	150	140	377	3.2	2.9	29%	28%	12.8	11.5	2.8	2.3	24%	22%
Tencent	700 HK	Buy	500	264	2,531	4.6	4.0	18%	20%	29.0	25.4	2.8	2.5	13%	15%
						4.3	4.0	26%	27%	20.0	17.6	3.5	3.0	21%	21%
e-commerce															
Alibaba	BABA US	Buy	145	84	223	0.2	0.2	9%	11%	1.7	1.4	0.2	0.2	12%	13%
Amazon	AMZN US	NR	-	121	1,234	2.4	2.0	3%	5%	81.8	31.3	8.2	6.5	10%	18%
Shopify	SHOP US	NR	-	32	34	6.2	5.0	-3%	0%	-236.4	613.9	5.0	5.3	-2%	0%
Rakuten	4755 JP	Buy	1,280	637	1,012	0.5	0.5	-15%	-5%	-4.3	-10.3	1.1	1.3	-26%	-13%
JD.Com	JD US	Buy	90	52	81	0.1	0.1	1%	2%	7.9	3.3	0.3	0.3	9%	12%
						1.9	1.6	-1%	2%	-29.9	127.9	3.0	2.7	1%	6%
Content platform															
Netflix	NFLX US	NR	-	241	107	3.4	3.1	18%	19%	23.5	19.9	5.4	4.5	23%	21%
Disney	DIS US	NR	-	101	185	2.1	1.9	12%	16%	22.7	18.5	2.0	1.8	8%	10%

Note: Closing price as of 4 October 2022. NR – Not Rated. PS – Price-to-Sales.
Source: Bloomberg, HSBC estimates (for covered stocks only).

Company section

Kakao (035720 KS)

- ◆ Kakao is now focusing on high-margin advertising and commerce...
- ◆ ...along with cost controls
- ◆ Upgrade to Buy from Hold with a new target price of KRW91k from KRW90k; our preferred stock in the Korean internet sector

Why do we change our view? We were previously more cautious on Kakao than the Street as we were concerned that investor expectations for the operator of Kakao Talk had become inflated. However, we now think it is time to take another look and, as a result, we upgrade our rating to Buy from Hold on: **1)** a recovery in Talk Biz, one of the key business segments of Kakao as it owns Kakao Talk, and **2)** cost controls, which can lead to a potential margin pick-up. Although the full impact of these two drivers will likely be seen in 2023e, we expect the share price can reflect the growing expectations for Kakao Corp's plans to revamp the Kakao Talk platform, a core business of the wider Kakao Group in 2H22e.

- ◆ **Focus on what the company does well:** Kakao's two key strategies for a recovery in Talk Biz sales growth are: **1)** ad inventory expansion, and **2)** changes to the "Friends" tab, which is one of the tabs where Kakao Talk users spend the longest time. For ads, the company plans to introduce SAs in 4Q22 along with the development of the open chat space, as well as increasing the portion of video ads within existing DAs. For e-commerce, Kakao plans to strengthen its social network function within the "Friends" tab on the Kakao Talk platform. Currently, users can know their friends' birthdays and send gifts to their friends through Talk Gift. We believe if Kakao makes changes to the "Friends" tab that allow users to share their daily events more often, e-commerce GMV can grow strongly. Given Talk Biz has led in terms of overall top-line growth for the past few years, we think this plan can boost Talk Biz's sales growth once again.
- ◆ **Potential margin pick-up through cost management:** Kakao said at the 2Q22 results conference call in August that it is managing costs, especially in the content area. Although it continues to expand the webtoon business (a platform operator for digital comic strips) to global markets (e.g. the US and Europe), we expect it will seek to manage costs in a way that doesn't damage top-line growth by tracking GMV growth rather than by loosely investing in large-scale marketing. According to the company, the domestic webtoon business is already recording positive margins and this means there is room for margin improvement in the global business, in our view. Thanks to cost management, we believe Kakao can improve its margins in 2H22e to about 11% from 9.5% in 1H22; this strategy will likely be maximised in 2023e and we estimate 2023e OPM to be c12% from 2022e OPM of c10%.

Upgrade to Buy from Hold with a new target price of KRW91k (from KRW90k): We slightly change our 2022-24e earnings estimates by factoring in better Talk Biz earnings, especially for 2024e, and this gives us a new target price. We continue to use a sum-of-the-parts (SOTP)-based valuation approach to derive our target price. Considering Kakao's parent (Exhibit 66) is now trading at a 2023e PE multiple of 16x, we believe the share price can rebound thanks to the strategic changes outlined above. Our 2023e OP estimate is 11% above Bloomberg consensus.

Financials & valuation: Kakao

Buy

Financial statements

Year to	12/2021a	12/2022e	12/2023e	12/2024e
Profit & loss summary (KRWbn)				
Revenue	6,137	7,518	9,242	11,019
EBITDA	968	965	1,269	1,519
Depreciation & amortisation	-373	-186	-177	-169
Operating profit/EBIT	595	779	1,092	1,350
Net interest	-3	-3	12	5
PBT	2,294	2,657	1,315	1,570
HSBC PBT	2,294	2,657	1,315	1,570
Taxation	-648	-850	-368	-440
Net profit	1,392	1,626	852	1,017
HSBC net profit	1,392	1,626	852	1,017
Cash flow summary (KRWbn)				
Cash flow from operations	1,307	2,829	2,034	1,638
Capex	-216	-100	-100	-100
Cash flow from investment	-3,341	286	-1,512	-1,605
Dividends	-24	-31	-40	-48
Change in net debt	-2,005	-3,400	-958	2,590
FCF equity	1,090	2,729	1,934	1,538
Balance sheet summary (KRWbn)				
Intangible fixed assets	6,348	6,289	6,233	6,179
Tangible fixed assets	555	527	506	491
Current assets	8,102	11,661	12,941	10,682
Cash & others	6,860	10,260	11,218	8,628
Total assets	21,814	24,515	26,652	25,287
Operating liabilities	4,916	5,726	6,736	7,778
Gross debt	1,793	1,793	1,793	1,793
Net debt	-5,067	-8,467	-9,425	-6,834
Shareholders' funds	9,984	11,581	12,394	9,759
Invested capital	3,229	2,492	1,726	946

Ratio, growth and per share analysis

Year to	12/2021a	12/2022e	12/2023e	12/2024e
y-o-y % change				
Revenue	47.6	22.5	22.9	19.2
EBITDA	34.0	-0.3	31.5	19.7
Operating profit	30.5	30.9	40.2	23.6
PBT	453.7	15.9	-50.5	19.4
HSBC EPS	77.5	16.8	-47.4	19.4
Ratios (%)				
Revenue/IC (x)	2.5	2.6	4.4	8.2
ROIC	21.1	19.9	39.2	75.6
ROE	17.1	15.1	7.1	9.2
ROA	9.7	7.6	3.5	4.2
EBITDA margin	15.8	12.8	13.7	13.8
Operating profit margin	9.7	10.4	11.8	12.2
EBITDA/net interest (x)	387.1	376.9	-	-
Net debt/equity	-37.3	-55.8	-58.9	-51.1
Net debt/EBITDA (x)	-5.2	-8.8	-7.4	-4.5
CF from operations/net debt	-	-	-	-
Per share data (KRW)				
EPS Rep (diluted)	3,122	3,647	1,919	2,290
HSBC EPS (diluted)	3,122	3,647	1,919	2,290
DPS	53	69	90	107
Book value	22,391	25,971	27,900	21,969

Valuation data

Year to	12/2021a	12/2022e	12/2023e	12/2024e
EV/sales	2.4	1.6	1.1	1.1
EV/EBITDA	14.9	12.3	7.8	7.6
PE*	17.9	15.3	29.1	24.4
PB	2.5	2.2	2.0	2.5
FCF yield (%)	4.5	11.2	7.9	6.3
Dividend yield (%)	0.1	0.1	0.2	0.2

* Based on HSBC EPS (diluted)

ESG metrics

Environmental Indicators	12/2021a	Governance Indicators	12/2021a
GHG emission intensity*	NA	No. of board members	7
Energy intensity*	NA	Average board tenure (years)	6.6
CO ₂ reduction policy	Yes	Female board members (%)	14.3
Social Indicators		Board members independence (%)	57.1
Employee costs as % of revenues	22.9		
Employee turnover (%)	NA		
Diversity policy	Yes		

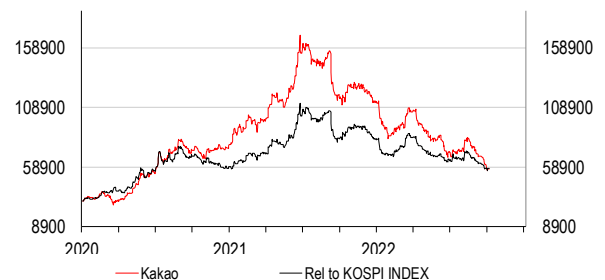
Source: Company data, HSBC

* GHG intensity and energy intensity are measured in kg and kWh respectively against revenue in USD '000s

Issuer information

Share price (KRW)	55,900.00	Free float	58%
Target price (KRW)	91,000.00	Sector	Internet Software & Services
RIC (Equity)	035720.KS	Country/Region	Korea
Bloomberg (Equity)	035720 KS	Analyst	Junhyun Kim
Market cap (USDm)	16,984	Contact	+82 2 3706 8763

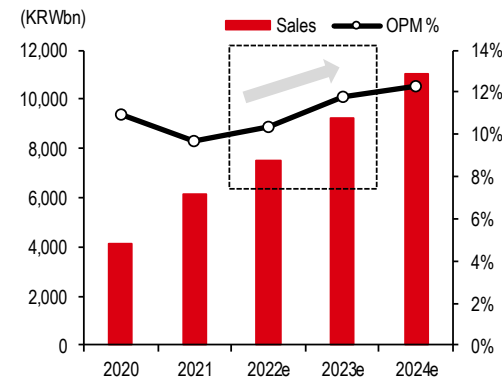
Price relative



Source: HSBC

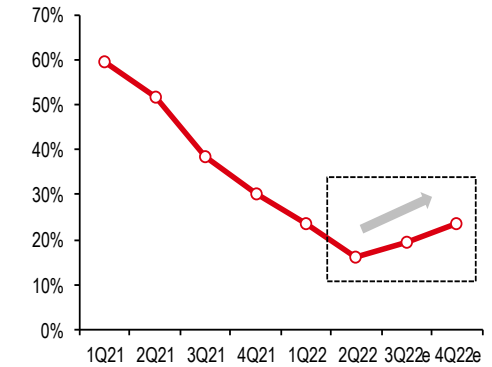
Note: Priced at close of 04 Oct 2022

Exhibit 57: Kakao – We see a potential margin pick-up thanks to cost controls



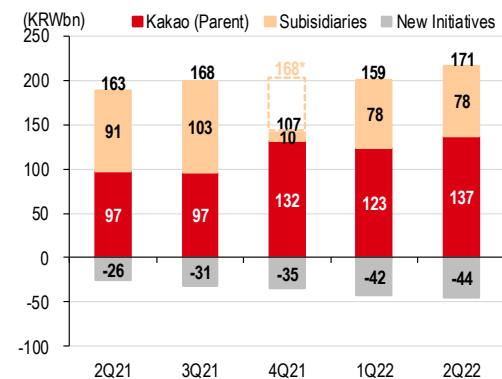
Source: Company data, HSBC estimates

Exhibit 58: Talk Biz sales y-o-y growth will rebound in 2H22e thanks to changes to the Talk Biz platform, in our view



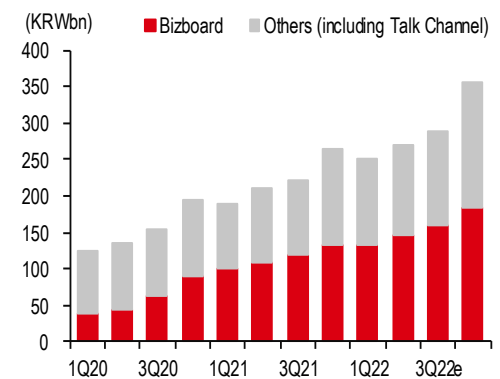
Source: Company data, HSBC estimates

Exhibit 59: Kakao – OP breakdown by segment



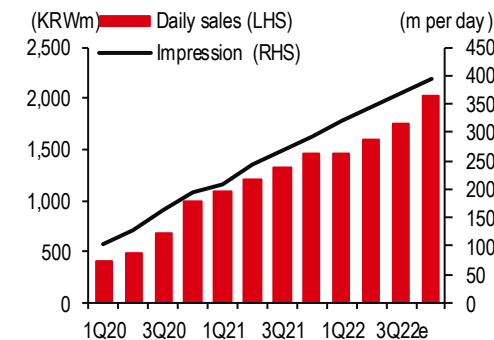
Note: Subsidiaries: All business segments, excluding Kakao & New initiatives/New initiatives: Kakao Enterprise, Kakao Brain, Kakao Healthcare (All unlisted) / * = 4Q21 OP excluding one-off incentive of KRW62bn.
Source: Company data

Exhibit 60: Kakao – Talk Biz advertisement sales trend



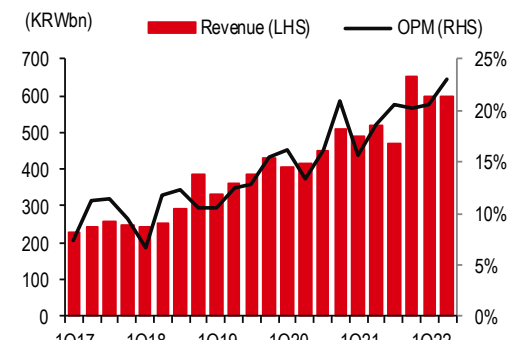
Source: Company data, HSBC estimates

Exhibit 61: Kakao – Assumptions for Bizboard (one of the ad products in Talk) daily sales and impressions



Source: Company data, HSBC estimates

Exhibit 62: Kakao parent earnings trend



Source: Company data

Exhibit 63: Kakao – Detailed earnings estimate changes

(KRWbn)	Old			New			Change		
	2022e	2023e	2024e	2022e	2023e	2024e	2022e	2023e	2024e
Revenue	7,489	9,090	10,618	7,518	9,242	11,019	0%	2%	4%
Platform	4,002	4,809	5,551	3,986	4,917	5,870	0%	2%	6%
Talk Biz	2,002	2,466	2,876	1,986	2,507	3,069	-1%	2%	7%
Portal Biz	459	464	470	459	464	470	0%	0%	0%
Platform - Others	1,541	1,879	2,205	1,541	1,945	2,331	0%	4%	6%
Content	3,487	4,281	5,066	3,532	4,325	5,149	1%	1%	2%
Game	1,359	1,651	1,872	1,359	1,651	1,872	0%	0%	0%
Music	796	939	1,033	796	939	1,033	0%	0%	0%
Story	963	1,348	1,753	979	1,313	1,755	2%	-3%	0%
Media	369	343	409	398	422	490	8%	23%	20%
Opex	6,682	7,988	9,412	6,739	8,149	9,669	1%	2%	3%
Labour cost	1,796	2,185	2,602	1,796	2,185	2,553	0%	0%	-2%
Cost of revenue	2,766	3,449	4,134	2,769	3,516	4,242	0%	2%	3%
Outsourcing and Infra	958	1,054	1,160	990	1,138	1,309	3%	8%	13%
Marketing	527	666	789	550	676	837	4%	1%	6%
D&A	542	623	716	542	623	716	0%	0%	0%
Others	11	11	11	11	11	11	0%	0%	0%
OP	807	1,102	1,205	779	1,092	1,350	-4%	-1%	12%
NP	1,735	906	975	1,626	852	1,017	-6%	-6%	4%
OPM	11%	12%	11%	10%	12%	12%	-0.4%p	-0.3%p	0.9%p
NPM	23%	10%	9%	22%	9%	9%	-1.5%p	-0.7%p	0.1%p

Note: Talk Biz (Kakao Talk ads and commerce, including Kakao Friends online), Portal Biz (Daum PC and mobile ads, Kakao Story/Style/Page), Platform - Others (Mobility, Pay, and other subsidiaries), Game (mobile and PC games, Kakao VX), Music (Kakao M, ticket), Story (Kakao Page, Daum Webtoon, and Piccoma), Media (Contents making, Management).
Source: HSBC estimates

Exhibit 64: Kakao – Estimates versus consensus

(KRWbn)	HSBC			Consensus			Difference		
	2022e	2023e	2024e	2022e	2023e	2024e	2022e	2023e	2024e
Sales	7,518	9,242	11,019	7,584	9,185	10,763	-1%	1%	2%
OP	779	1,092	1,350	746	987	1,256	4%	11%	7%
Net profit	1,626	852	1,017	1,701	744	920	-4%	15%	11%
OPM	10%	12%	12%	10%	11%	12%	0.5%p	1.1%p	0.6%p
NPM	22%	9%	9%	22%	8%	9%	-0.8%p	1.1%p	0.7%p

Source: Bloomberg consensus, HSBC estimates

Exhibit 65: Kakao – Earnings trends and estimates

(KRWbn)	1Q21a	2Q21a	3Q21a	4Q21a	1Q22a	2Q22a	3Q22e	4Q22e	2021a	2022e	2023e	2024e
Sales	1,258	1,352	1,741	1,786	1,652	1,822	1,958	2,086	6,137	7,518	9,242	11,019
% y-o-y	45%	42%	58%	45%	31%	35%	13%	17%	48%	23%	23%	19%
Platform	696	762	779	1,005	886	931	1,004	1,165	3,241	3,986	4,917	5,870
Talk Biz	374	390	405	475	461	453	484	588	1,644	1,986	2,507	3,069
Portal Biz	117	125	119	131	114	102	119	124	493	459	464	470
Platform - Others	205	246	255	399	311	375	401	453	1,104	1,541	1,945	2,331
Content	562	590	962	781	766	892	954	921	2,896	3,532	4,325	5,149
Game	130	129	463	277	246	337	397	379	773	1,359	1,651	1,872
Music	185	188	197	203	204	209	189	193	792	796	939	1,033
Story	175	186	219	212	240	228	263	248	999	979	1,313	1,755
Media	73	87	83	89	75	118	105	100	333	398	422	490
Opex	1,100	1,190	1,573	1,679	1,493	1,651	1,746	1,849	5,542	6,739	8,149	9,669
% y-o-y	41%	39%	60%	55%	36%	39%	11%	10%	50%	22%	21%	19%
Labour cost	293	301	307	516	420	426	458	492	1,417	1,796	2,185	2,553
Cost of revenue	493	530	806	648	584	655	748	782	2,477	2,769	3,516	4,242
Outsourcing and Infra	144	165	198	234	205	236	257	292	741	990	1,138	1,309
Marketing	67	91	148	129	115	150	143	142	435	550	676	837
D&A	79	79	89	120	131	136	137	138	367	542	623	716
Others	4	1	2	2	1	4	3	2	9	11	11	11
OP	158	163	168	107	159	171	213	237	595	779	1,092	1,350
OPM	12.5%	12%	10%	6.0%	9.6%	9%	11%	11%	10%	10%	12%	12%
NP (controlling interest)	225	312	779	77	1,303	68	157	99	1,392	1,626	852	1,017
NPM	18%	23%	45%	4%	79%	4%	8%	5%	23%	22%	9%	9%

Source: Company data, HSBC estimates

Exhibit 66: Kakao – SOTP valuation summary

	2023e NOPAT (KRWbn)	Target (x)	EV (KRWbn)	Stake (%)	Stake value (KRWbn)
Kakao ad and commerce	780	25.0x	19,492	100.0%	19,492
Kakao subsidiary value					17,751
- Kakao Games			5,035	43.3%	1,744
- Kakao Mobility			4,969	57.3%	2,847
- Kakao Pay			7,873	47.0%	2,960
- Kakao Entertainment			10,248	73.6%	7,542
- Kakao Bank			12,210	27.2%	2,657
Fair value					37,243
Fair value per share (KRW)					90,849
HSBC Target Price (KRW)					91,000
Current price (KRW)					55,900
Implied upside/downside					62.8%

Source: HSBC estimates. Note: Closing price as of 4 October 2022.

Exhibit 67: Kakao – Calculation of implied PE multiple of Kakao parent

KRWbn	Fair value	Stake	Stake value	Note
Kakao's current market cap			24,381	As of 4 October 2022
NAV sum of key subsidiaries			17,751	
- Kakao Mobility	4,969	57.3%	2,847	Based on third-party investment valuation
- Kakao Games	5,035	43.3%	1,744	HSBC estimated fair value
- Kakao Pay	7,873	47.0%	2,960	HSBC estimated fair value
- Kakao Entertainment	10,248	73.6%	7,542	Based on third-party investment valuation
- Kakao Bank	12,210	27.2%	2,657	HSBC estimated fair value
Implied Kakao parent value			6,630	
2023e core NP			780	
Implied 2023e PE (x)			8.5x	

Source: Company data, HSBC estimates

Valuation and risks

		Valuation	Risks
Kakao 035720 KS Buy	Current price: KRW55,900 Target price: KRW91,000 Up/downside: 62.8%	<p>We continue to use a SOTP-based valuation approach. We value the parent Kakao's business at KRW19.5trn (from KRW19.0trn), based on a 25.0x (unchanged) PE target multiple applied to our 2023e NOPAT estimate of KRW780bn (from KRW761bn). This multiple is based on Naver's (035420 KS, KRW176,500, Buy) lower end PE multiple during 2013-17 when its ad and e-commerce business expanded. We value the stake in Kakao Entertainment (73.6% held) at KRW7.5trn, based on a third-party investment valuation. We value Kakao's subsidiaries at KRW17.8trn (from KRW17.9trn), comprising: 1) KRW1.7trn (from KRW1.9trn), reflecting our fair value estimate of KRW65k for Kakao Games (43.3% held); 2) KRW2.7trn (from KRW2.9trn), reflecting our fair value estimate of Kakao Bank (27.2% stake); 3) KRW3.0trn (from KRW3.7trn), reflecting our fair value estimate of KRW59,700 of Kakao Pay (47% held); and 4) other subsidiaries – e.g. Kakao Mobility – based on the implied valuations from their respective most recent capital increase. Our new target price implies 62.8% upside from the current share price, and we upgrade our rating to Buy from Hold as we focus on Kakao's plans for Talk Biz and believe the market will positively react to these changes.</p> <p>Junhyun Kim* junhyun.kim@kr.hsbc.com +82 2 3706 9763</p>	<p>Key downside risks: 1) Any potential regulation that can threaten Kakao's margin recovery; 2) increasing competition from Naver in fintech and the content business; 3) a more significant increase in marketing or labour costs versus our estimates; and 4) delays in new business monetisation and new service launches like the independent open chat app.</p>

Priced at 4 October 2022.

 * Employed by a non-US affiliate of HSBC Securities (USA) Inc, and is not registered/qualified pursuant to FINRA regulations
 Source: Bloomberg, HSBC estimates

Naver (035420 KS)

- ◆ Investors' key concern is the operating profit margin contraction...
- ◆ ...but we see potential for a margin pick-up thanks to:
 - 1) better monetisation in e-commerce, and
 - 2) fast-growing global webtoon GMV
- ◆ Maintain Buy with a lower target price to KRW270k from KRW360k

What has driven the sluggish share price performance? Up until 1H21, Naver's share price was rallying on the back of its strong top-line growth, despite an operating profit margin contraction due to cost pressures not only from labour cost hikes but also from aggressive marketing related to the global expansion of its webtoon business (a publisher of digital comic strips). However, starting from 3Q21, its top-line growth started to slow as the economy hit a "speed bump" and investor sentiment worsened. Nevertheless, we continue to have a positive view on Naver as we see two key reasons for a potential margin pick-up: **1)** better monetisation in e-commerce, and **2)** a potential acceleration in GMV growth at its global webtoon business.

- ◆ **Better monetisation in e-commerce:** Despite a slowdown in Naver Shopping GMV growth, we focus on stronger revenue growth in e-commerce, which means better profitability thanks to an increase in the blended take rate. Although Naver's GMV ranking in Korea will likely be reversed by Coupang in 2022e, in our view, we expect Naver's GMV growth to be solid at about 18%, substantially higher than the average Korean e-commerce GMV growth of 7% thanks to rising user customer loyalty and more diversified commerce categories based on strengthened vertical commerce services (i.e. commerce focusing on a very specific area). However, a larger-than-expected negative impact related to margin deterioration in commerce related to the acquisition of PoshMark (POSH US, USD17.61, Not Rated) can be a risk.
- ◆ **Reasonable investment in global webtoon business:** According to news reports (Yonhap, 7 September 2022), the combined GMV at Line Manga (an online manga and webtoon platform and smartphone app operated by Line) and eBook Japan exceeded JPY10bn (about KRW97bn) for the first time in August 2022. Considering monthly GMV was about KRW73bn on average during 2Q22, this means c33% q-o-q growth in GMV in the Japanese market. Although we need to wait to see whether this trend will continue, we see a potential margin pick-up in Naver's global webtoon business on the back of fast-growing GMV. We assume global webtoon GMV will jump to KRW2.2trn (up 30% y-o-y) in 2023e from KRW1.7trn (up 19% y-o-y) in 2022e. We believe GMV growth in the overseas market will impact the overall revenue-to-GMV ratio in the future, positive for earnings.

We lower our target price by 25% to KRW270k from KRW360k but maintain our Buy rating: We lower our 2022-23e earnings estimates by 3% and 1%, respectively, and lower our target PE multiple for Naver Platform's fair value to 19.8x from 33x by applying a 20% discount, given the worsening investor sentiment amid the slowdown in the top line for platform companies, to the average low-end PE multiple during the past 10 years when they recorded lower y-o-y OP growth than in the previous year (24.7x), resulting in our target price. Although we now prefer Kakao over Naver due to its planned changes to the Talk platform, we believe Naver deserves investor attention, given potential margin expansion.

Financials & valuation: Naver

Buy

Financial statements

Year to	12/2021a	12/2022e	12/2023e	12/2024e
Profit & loss summary (KRWbn)				
Revenue	6,818	8,161	9,851	11,737
EBITDA	1,759	1,871	2,296	2,785
Depreciation & amortisation	-433	-503	-505	-481
Operating profit/EBIT	1,325	1,368	1,791	2,303
Net interest	-25	-54	-56	-53
PBT	2,126	1,453	2,278	3,114
HSBC PBT	2,126	1,453	2,278	3,114
Taxation	13,121	-443	-706	-965
Net profit	15,259	1,119	1,657	2,149
HSBC net profit	15,259	1,119	1,657	2,149
Cash flow summary (KRWbn)				
Cash flow from operations	1,380	1,512	2,670	3,332
Capex	-754	-700	-500	-400
Cash flow from investment	-13,999	-2,286	-2,749	-2,693
Dividends	-84	-81	-111	-111
Change in net debt	1,235	895	-85	-894
FCF equity	626	812	2,170	2,932
Balance sheet summary (KRWbn)				
Intangible fixed assets	932	870	820	780
Tangible fixed assets	2,111	2,371	2,415	2,374
Current assets	5,042	4,564	5,063	6,418
Cash & others	3,582	2,568	2,653	3,547
Total assets	33,205	34,510	37,252	40,819
Operating liabilities	3,786	4,167	4,987	5,902
Gross debt	3,650	3,531	3,531	3,531
Net debt	68	964	879	-15
Shareholders' funds	23,536	24,581	26,138	28,186
Invested capital	717	1,070	658	123

Ratio, growth and per share analysis

Year to	12/2021a	12/2022e	12/2023e	12/2024e
y-o-y % change				
Revenue	28.5	19.7	20.7	19.1
EBITDA	2.8	6.4	22.7	21.3
Operating profit	9.1	3.2	30.9	28.6
PBT	30.2	-31.7	56.8	36.7
HSBC EPS	1695.6	-92.7	48.1	29.6
Ratios (%)				
Revenue/IC (x)	4.9	9.1	11.4	30.1
ROIC	700.7	111.2	147.0	414.4
ROE	98.8	4.7	6.5	7.9
ROA	61.3	2.9	4.3	5.5
EBITDA margin	25.8	22.9	23.3	23.7
Operating profit margin	19.4	16.8	18.2	19.6
EBITDA/net interest (x)	69.9	34.8	41.1	52.1
Net debt/equity	0.3	3.9	3.3	-0.1
Net debt/EBITDA (x)	0.0	0.5	0.4	-0.0
CF from operations/net debt	2015.6	156.9	303.8	-
Per share data (KRW)				
EPS Rep (diluted)	93,016	6,821	10,103	13,099
HSBC EPS (diluted)	93,016	6,821	10,103	13,099
DPS	511	493	674	674
Book value	143,467	149,839	159,328	171,813

Valuation data

Year to	12/2021a	12/2022e	12/2023e	12/2024e
EV/sales	0.3	0.1	-0.1	-0.4
EV/EBITDA	1.1	0.6	-0.5	-1.6
PE*	1.9	25.9	17.5	13.5
PB	1.2	1.2	1.1	1.0
FCF yield (%)	2.4	3.1	8.2	11.1
Dividend yield (%)	0.3	0.3	0.4	0.4

* Based on HSBC EPS (diluted)

ESG metrics

Environmental Indicators	12/2021a	Governance Indicators	12/2021a
GHG emission intensity*	13.2	No. of board members	7
Energy intensity*	76.8	Average board tenure (years)	NA
CO ₂ reduction policy	Yes	Female board members (%)	14.3
Social Indicators		Board members independence (%)	57.1
Employee costs as % of revenues	7.4		
Employee turnover (%)	5.3		
Diversity policy	Yes		

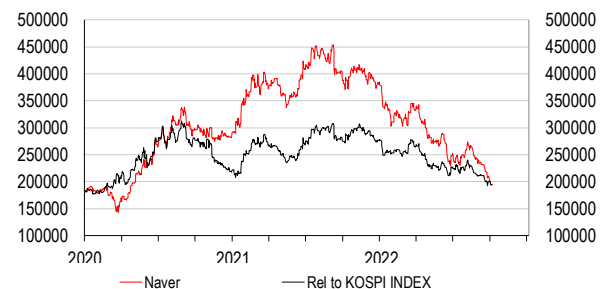
Source: Company data, HSBC

* GHG intensity and energy intensity are measured in kg and kWh respectively against revenue in USD '000s

Issuer information

Share price (KRW)	176,500.00	Free float	58%
Target price (KRW)	270,000.00	Sector	Internet Software & Services
RIC (Equity)	035420.KS	Country/Region	Korea
Bloomberg (Equity)	035420 KS	Analyst	Junhyun Kim
Market cap (USDm)	18,416	Contact	+82 2 3706 8763

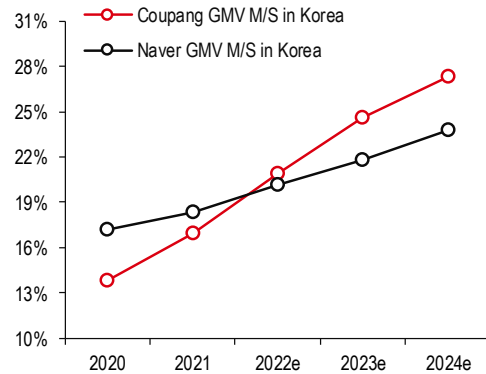
Price relative



Source: HSBC

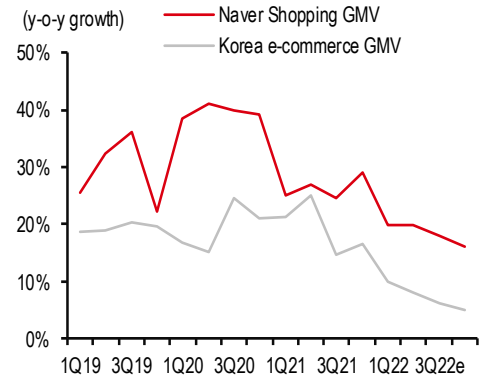
Note: Priced at close of 04 Oct 2022

Exhibit 68: Although we think Naver Shopping GMV market share will likely be lower than Coupang in 2022e...



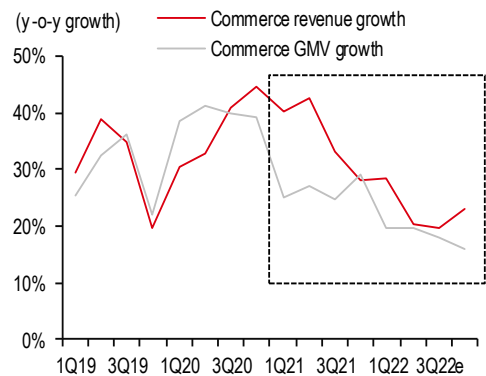
Source: Company data, HSBC estimates. Note: M/S – market share.

Exhibit 69: ...we expect Naver will continue to beat the average Korean e-commerce GMV growth in 2H22e



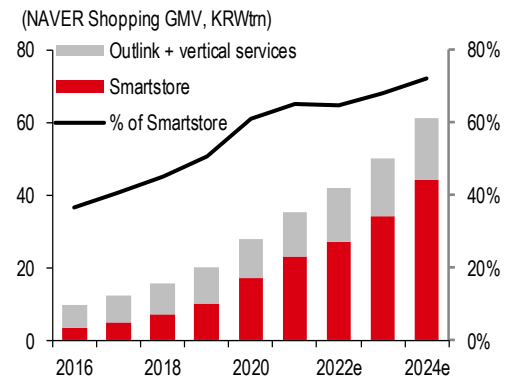
Source: Statistics Korea, Company data, HSBC estimates

Exhibit 70: Naver – Higher revenue growth than GMV in e-commerce



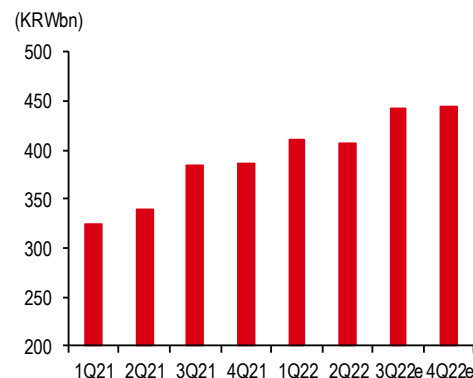
Source: Company data, HSBC estimates

Exhibit 71: Naver – Naver Shopping GMV breakdown



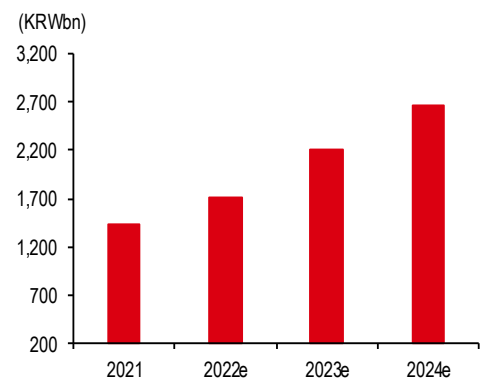
Source: Company data, HSBC estimates

Exhibit 72: Naver Webtoon – Quarterly GMV trend



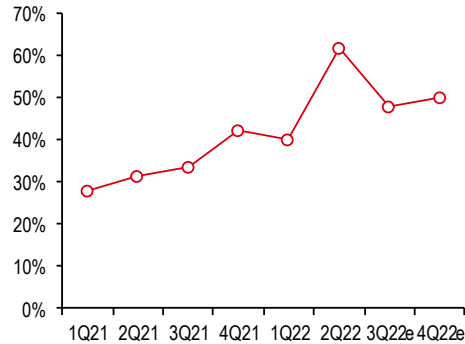
Source: Company data, HSBC estimates

Exhibit 73: Naver Webtoon – Annual GMV trend



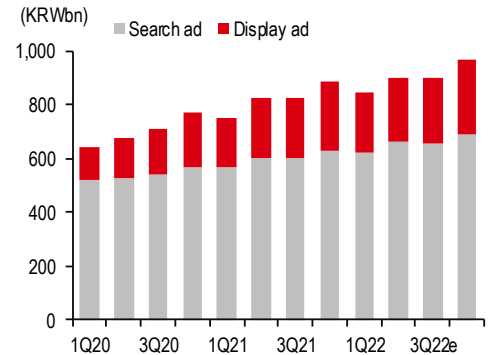
Source: Company data, HSBC estimates

Exhibit 74: Naver Webtoon – Quarterly revenue-to-GMV ratio



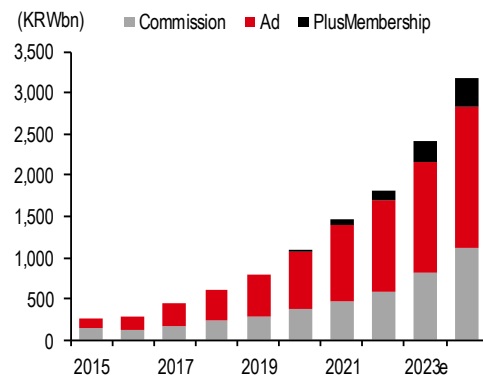
Source: Company data, HSBC estimates

Exhibit 75: Naver – Search Platform (search and display ad) sales trend



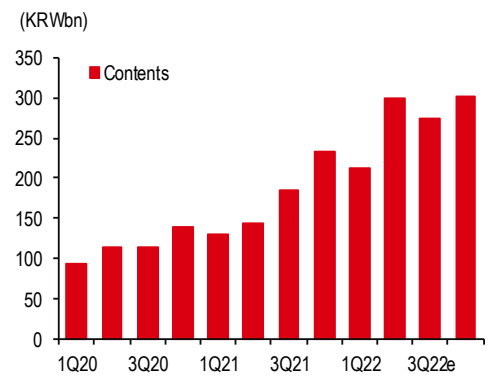
Source: Company data, HSBC estimates

Exhibit 76: Naver – Commerce sales should reach a CAGR of 31% in 2020-24e



Source: Company data, HSBC estimates

Exhibit 77: Naver – Strong content sales growth



Source: Company data, HSBC estimates

Exhibit 78: Naver – Detailed earnings estimate changes

(KRWbn)	Old			New			Change		
	2022e	2023e	2024e	2022e	2023e	2024e	2022e	2023e	2024e
Sales	8,240	9,780	11,232	8,161	9,851	11,737	-1%	1%	4%
Search Platform	3,627	3,898	4,149	3,628	3,898	4,150	0%	0%	0%
Commerce	1,812	2,242	2,663	1,809	2,406	3,185	0%	7%	20%
Fintech	1,216	1,486	1,776	1,216	1,499	1,904	0%	1%	7%
Contents	1,146	1,584	1,901	1,087	1,501	1,786	-5%	-5%	-6%
Cloud	439	571	742	421	547	711	-4%	-4%	-4%
Opex	6,833	7,926	8,951	6,793	8,061	9,433	-1%	2%	5%
Development & operations	2,082	2,459	2,860	2,082	2,459	2,860	0%	0%	0%
Partner	2,897	3,451	3,956	2,868	3,476	4,133	-1%	1%	4%
Infrastructure	557	574	591	557	574	591	0%	0%	0%
Marketing	1,297	1,442	1,544	1,285	1,552	1,849	-1%	8%	20%
OP	1,407	1,855	2,281	1,368	1,791	2,303	-3%	-3%	1%
NP	1,183	1,763	2,132	1,119	1,657	2,149	-5%	-6%	1%
OPM	17%	19%	20%	17%	18%	20%	0%p	-1%p	-1%p
NPM	14%	18%	19%	14%	17%	18%	-1%p	-1%p	-1%p

Source: Company data, HSBC estimates

Exhibit 79: Naver – Earnings estimate changes and estimates versus consensus

(KRWbn)	Old			New			Change			Consensus			Difference		
	2022e	2023e	2024e	2022e	2023e	2024e	2022e	2023e	2024e	2022e	2023e	2024e	2022e	2023e	2024e
Sales	8,240	9,780	11,232	8,161	9,851	11,737	-1%	1%	4%	8,278	9,768	11,353	-1%	1%	3%
OP	1,407	1,855	2,281	1,368	1,791	2,303	-3%	-3%	1%	1,380	1,672	2,082	-1%	7%	11%
Net profit	1,183	1,763	2,132	1,119	1,657	2,149	-5%	-6%	1%	1,053	1,408	1,709	6%	18%	26%
OPM	17%	19%	20%	17%	18%	20%	0%p	-1%p	-1%p	17%	17%	18%	0%p	1%p	1%p
NPM	14%	18%	19%	14%	17%	18%	-1%p	-1%p	-1%p	13%	14%	15%	1%p	2%p	3%p

Source: Bloomberg consensus estimates, HSBC estimates

Exhibit 80: Naver – Earnings trend and estimates

(KRWbn)	1Q21	2Q21	3Q21	4Q21	1Q22	2Q22	3Q22e	4Q22e	2021	2022e	2023e	2024e
Revenue	1,499	1,664	1,727	1,928	1,845	2,046	2,050	2,220	6,818	8,161	9,851	11,737
y-o-y	30%	30%	27%	27%	23%	23%	19%	15%	29%	20%	21%	19%
Search Platform	753	826	825	887	850	906	902	971	3,290	3,628	3,898	4,150
Commerce	324	365	380	405	416	439	455	498	1,475	1,809	2,406	3,185
Fintech	210	233	242	295	275	296	313	333	979	1,216	1,499	1,904
Contents	131	145	184	233	212	300	274	301	693	1,087	1,501	1,786
Cloud	82	95	96	107	92	105	106	118	380	421	547	711
Opex	1,210	1,328	1,378	1,576	1,543	1,710	1,707	1,833	5,492	6,793	8,061	9,433
y-o-y	40%	37%	29%	33%	28%	29%	24%	16%	34%	24%	19%	17%
Development & operations	374	400	389	466	472	515	528	567	1,629	2,082	2,459	2,860
Partner	510	582	609	715	624	720	722	802	2,415	2,868	3,476	4,133
Infrastructure	155	171	178	183	133	141	141	141	687	557	574	591
Marketing	171	176	202	213	315	333	315	322	761	1,285	1,552	1,849
OP	289	336	350	351	302	336	343	387	1,325	1,368	1,791	2,303
OPM	19%	20%	20%	18%	16%	16%	17%	17%	19%	17%	18%	20%
NP	15,310	528	332	320	171	183	322	442	16,490	1,119	1,657	2,149
NPM	1021%	32%	19%	17%	9%	9%	16%	20%	242%	14%	17%	18%

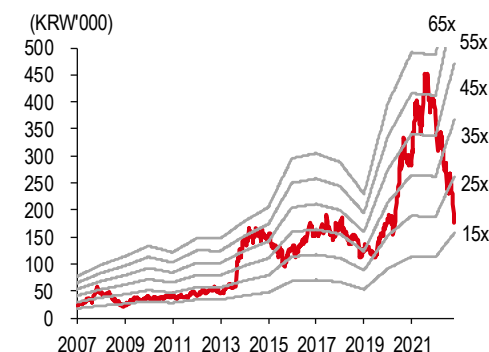
Source: Company data, HSBC estimates

Exhibit 81: Naver – SOTP valuation changes

	New			Old			Difference	
	Portion of fair value	Fair value (KRWbn)	Fair value/share (KRW)	Portion of fair value	Fair value (KRWbn)	Fair value/share (KRW)	Change in fair value	Change in fair value/share
(A) Naver Platform	34%	13,059	89,000	46%	23,878	163,000	-45%	-45%
- Net profit (2022e)		660			724		-9%	
- Target PE		19.8			33.0		-40%	
(B) Naver Shopping	62%	24,004	164,000	50%	26,200	179,000	-8%	-8%
- GMV (2022e)		41,752			41,830		0%	
- Mkt value/GMV (x)		0.57			0.63		-8%	
(C) Naver Financial	5%	1,865	13,000	4%	1,865	13,000	0%	0%
- Implied value		2,664			2,664		0%	
- Naver's stake		70%			70%		0%	
Fair value (A)+(B)+(C)		38,928	270,000		51,943	360,000	-25%	-25%
HSBC target price			270,000			360,000		-25%
Share price			176,500					
Implied upside			53.0%					

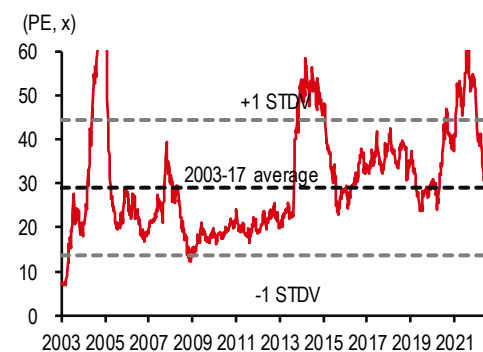
Source: Bloomberg, HSBC estimates. Note: Given the business integration of LINE and ZHD and resultant delisting of LINE, we exclude the value of LINE from our valuation. Priced at 4 October 2022.

Exhibit 82: Naver – 12-month forward PE band



Source: Bloomberg, Company data, HSBC estimates

Exhibit 83: Naver – 12-month forward PE trend



Source: Bloomberg, Company data, HSBC estimates

Valuation and risks

	Valuation	Risks
Naver 035420 KS Buy	<p>Current price: KRW176,500</p> <p>Target price: KRW270,000</p> <p>Up/downside: 53.0%</p> <p>We continue to use a SOTP-based valuation approach. We believe the potential share price drivers remain intact and a series of positive KPIs for Naver Financial and Naver Webtoon should remain ongoing potential share price catalysts. We value: 1) Naver Platform at KRW13.1trn (from KRW23.9trn) based on a new target PE multiple of 19.8x – we apply a 20% discount to the 12-month forward PE multiple of 24.7x (the average low-end PE during the past 10 years when recorded lower OP margin than previous year) – to reflect the recent sluggish share price performance from 33x (the average during 2015-16 when EPS grew at a CAGR of 30% with monetisation ramping-up across search); 2) Naver Shopping at KRW24trn (from KRW26.2trn) based on 2022e GMV of KRW41.8trn (unchanged) and a target PE multiple of 0.57x (the average PE multiple of Shopify (SHOP US, USD31.53, Not Rated) and eBay (EBAY US, USD38.67, Not Rated) in 2021 from a PE multiple of 0.63x, the same peers but on a 2020 basis); 3) its 70% stake in Naver Financial at KRW1.9trn (unchanged) based on a third-party investment valuation in December 2019. Our new target price implies upside of 53.0% and we maintain our Buy rating; we believe value-accretive Naver Financial and positive synergies from business integration should drive the share price higher.</p> <p>Junhyun Kim* junhyun.kim@kr.hsbc.com +82 2 3706 8763</p>	<p>Key downside risks: 1) Intensifying competition in the domestic ad market could be a threat to margins; 2) any potential market share lose in e-commerce; 3) unexpected cost hikes drive by global business expansion, which could deteriorate margins; and 4) regulatory risks.</p>

Priced at 4 October 2022.

* Employed by a non-US affiliate of HSBC Securities (USA) Inc, and is not registered/qualified pursuant to FINRA regulations

Source: Bloomberg, HSBC estimates

Coupang (CPNG US)

- ◆ Coupang, a leading e-commerce company in Korea, is on course to become the market leader and turn profitable, in our view
- ◆ It is growing GMV much faster than the market average and margins are set to rise
- ◆ Initiate at Buy with a target price of USD27.80

Ready to become the market leader

Taking the lead. Coupang, a leading e-commerce company, has seen its share price slump due to a fall in the growth of GMV in Korea as the country emerges from the pandemic and concerns grow about operating losses – investors want to know when the fast-growing company will turn profitable. We have a positive view on both these factors. First, we believe Coupang is in the process of overtaking Naver (035420 KS, KRW176,500, Buy) as the market leader in GMV. Second, in our view, Coupang will turn profitable for the first time in 2023e.

GMV and profits. Coupang's GMV is now growing faster than the market average, mainly because of its superior fulfilment and logistics services, which guarantee on-time delivery. We forecast KRW-based GMV growth of 33% y-o-y in 2022e (15% y-o-y in USD to reflect the FX rate) vs. 7% y-o-y (down 7% y-o-y in USD) for the overall Korean online shopping market. This should increase Coupang's market share, putting it ahead of Naver. We believe the dip in GMV growth is temporary, the result of Korea emerging from the pandemic and higher inflation, which is hitting consumers. At the same time, expansion into higher margin categories, increased operating leverage, cost efficiencies, and the potential to raise prices can increase margins. As a result, we expect Coupang to turn profitable next year.

Our growth estimates. We estimate Coupang will achieve its first operating profit (OP) in 2023e and expand its OP margin to 3% in 2024e. Our 2023-24e estimates are significantly above consensus as we are more bullish on the gross profit (GP) margin and cost efficiency. We think the GP margin will improve thanks to the rapid growth of high-margin third-party merchant services. The main risk to our OP estimates is higher-than-expected costs related to the expansion in Taiwan and Japan.

Valuation and risks. We use a target EV/GMV multiple of 1.26x, which is the 2021 average of peers like Amazon (AMZN US, USD121.09, Not Rated) and JD.com (JD US, CMP USD52.04, Buy), which both have similar GMV-to-revenue conversion ratios. Applying this multiple to our 2023e GMV estimate of USD39bn, we get a rounded target price of USD27.80. The stock is now trading at a 2023e EV/GMV of 0.76x. **Key downside risks:** 1) SoftBank (9984 JP, JPY5,235, Hold) stock overhang; 2) an economic downturn; 3) a fall in user numbers; and 4) FX changes can affect USD-based reported earnings as most revenues are in KRW.

For details, see [Initiate at Buy: Ready to become the market leader](#), 6 October 2022.

Financials & valuation: Coupang Inc

Buy

Financial statements

Year to	12/2021a	12/2022e	12/2023e	12/2024e
Profit & loss summary (USDm)				
Revenue	18,406	19,789	23,775	29,178
EBITDA	-1,292	-458	373	1,194
Depreciation & amortisation	201	265	330	375
Operating profit/EBIT	-1,494	-723	44	819
Net interest	-37	-11	0	8
PBT	-1,542	-751	16	791
HSBC PBT	0	0	0	0
Taxation	1	3	0	190
Net profit	-1,543	-753	16	601
HSBC net profit	-1,543	-753	16	601
Cash flow summary (USDm)				
Cash flow from operations	-411	-124	1,545	2,380
Capex	-672	-761	-891	-1,108
Cash flow from investment	-676	-799	-936	-1,162
Dividends	0	0	0	0
Change in net debt	-2,101	784	-815	-1,395
FCF equity	-1,082	-886	653	1,272
Balance sheet summary (USDm)				
Intangible fixed assets	1,384	1,338	1,673	2,118
Tangible fixed assets	1,348	1,857	2,225	2,469
Current assets	5,637	5,515	6,532	8,442
Cash & others	3,488	3,101	3,747	5,141
Total assets	8,642	9,094	10,894	13,549
Operating liabilities	5,546	6,050	7,744	9,521
Gross debt	920	1,318	1,148	1,148
Net debt	-2,568	-1,783	-2,599	-3,993
Shareholders' funds	2,176	1,726	2,002	2,880
Invested capital	-665	-442	-1,060	-1,633

Ratio, growth and per share analysis

Year to	12/2021a	12/2022e	12/2023e	12/2024e
y-o-y % change				
Revenue	53.8	7.5	20.1	22.7
EBITDA	-	-	-	219.8
Operating profit	-	-	-	1775.9
PBT	-	-	-	4917.6
HSBC EPS	-	-	-	3696.2
Ratios (%)				
Revenue/IC (x)	-19.1	-35.7	-31.6	-21.7
ROIC	113.1	34.6	-93.2	-144.5
ROE	-141.8	-38.6	0.8	24.6
ROA	-22.5	-8.5	0.2	4.9
EBITDA margin	-7.0	-2.3	1.6	4.1
Operating profit margin	-8.1	-3.7	0.2	2.8
Net debt/equity	-118.0	-103.3	-129.8	-138.7
Net debt/EBITDA (x)	2.0	3.9	-7.0	-3.3
Per share data (USD)				
EPS Rep (diluted)	-0.87	-0.43	0.01	0.34
HSBC EPS (diluted)	-0.87	-0.43	0.01	0.34
DPS	0.00	0.00	0.00	0.00
Book value	1.23	0.98	1.13	1.63

Valuation data

Year to	12/2021a	12/2022e	12/2023e	12/2024e
EV/sales	1.5	1.7	1.3	1.0
EV/EBITDA	NM	NM	83.5	24.7
PE*	NM	NM	2179.9	57.4
PB	14.2	20.0	17.2	12.0
FCF yield (%)	-3.5	-2.9	2.1	4.1
Dividend yield (%)	0.0	0.0	0.0	0.0

* Based on HSBC EPS (diluted)

ESG metrics

Environmental Indicators	12/2021a	Governance Indicators	12/2021a
GHG emission intensity*	NA	No. of board members	7
Energy intensity*	NA	Average board tenure (years)	NA
CO ₂ reduction policy	Yes	Female board members (%)	0
Social Indicators		Board members independence (%)	42.9
12/2021a			
Employee costs as % of revenues	NA		
Employee turnover (%)	NA		
Diversity policy	Yes		

Source: Company data, HSBC

* GHG intensity and energy intensity are measured in kg and kWh respectively against revenue in USD '000s

Issuer information

Share price (USD)	19.56	Free float	52%
Target price (USD)	27.80	Sector	Internet Software & Services
RIC (Equity)	CPNG.N	Country/Region	Korea
Bloomberg (Equity)	CPNG US	Analyst	Junhyun Kim
Market cap (USDm)	34,526	Contact	+82 2 3706 8763

Price relative



Source: HSBC

Note: Priced at close of 04 Oct 2022

Disclosure appendix

Analyst Certification

The following analyst(s), economist(s), or strategist(s) who is(are) primarily responsible for this report, including any analyst(s) whose name(s) appear(s) as author of an individual section or sections of the report and any analyst(s) named as the covering analyst(s) of a subsidiary company in a sum-of-the-parts valuation certifies(y) that the opinion(s) on the subject security(ies) or issuer(s), any views or forecasts expressed in the section(s) of which such individual(s) is(are) named as author(s), and any other views or forecasts expressed herein, including any views expressed on the back page of the research report, accurately reflect their personal view(s) and that no part of their compensation was, is or will be directly or indirectly related to the specific recommendation(s) or views contained in this research report: Junhyun Kim

Important disclosures

Equities: Stock ratings and basis for financial analysis

HSBC and its affiliates, including the issuer of this report ("HSBC") believes an investor's decision to buy or sell a stock should depend on individual circumstances such as the investor's existing holdings, risk tolerance and other considerations and that investors utilise various disciplines and investment horizons when making investment decisions. Ratings should not be used or relied on in isolation as investment advice. Different securities firms use a variety of ratings terms as well as different rating systems to describe their recommendations and therefore investors should carefully read the definitions of the ratings used in each research report. Further, investors should carefully read the entire research report and not infer its contents from the rating because research reports contain more complete information concerning the analysts' views and the basis for the rating.

From 23rd March 2015 HSBC has assigned ratings on the following basis:

The target price is based on the analyst's assessment of the stock's actual current value, although we expect it to take six to 12 months for the market price to reflect this. When the target price is more than 20% above the current share price, the stock will be classified as a Buy; when it is between 5% and 20% above the current share price, the stock may be classified as a Buy or a Hold; when it is between 5% below and 5% above the current share price, the stock will be classified as a Hold; when it is between 5% and 20% below the current share price, the stock may be classified as a Hold or a Reduce; and when it is more than 20% below the current share price, the stock will be classified as a Reduce.

Our ratings are re-calibrated against these bands at the time of any 'material change' (initiation or resumption of coverage, change in target price or estimates).

Upside/Downside is the percentage difference between the target price and the share price.

Prior to this date, HSBC's rating structure was applied on the following basis:

For each stock we set a required rate of return calculated from the cost of equity for that stock's domestic or, as appropriate, regional market established by our strategy team. The target price for a stock represented the value the analyst expected the stock to reach over our performance horizon. The performance horizon was 12 months. For a stock to be classified as Overweight, the potential return, which equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated, had to exceed the required return by at least 5 percentage points over the succeeding 12 months (or 10 percentage points for a stock classified as Volatile*). For a stock to be classified as Underweight, the stock was expected to underperform its required return by at least 5 percentage points over the succeeding 12 months (or 10 percentage points for a stock classified as Volatile*). Stocks between these bands were classified as Neutral.

*A stock was classified as volatile if its historical volatility had exceeded 40%, if the stock had been listed for less than 12 months (unless it was in an industry or sector where volatility is low) or if the analyst expected significant volatility. However, stocks which we did not consider volatile may in fact also have behaved in such a way. Historical volatility was defined as the past month's average of the daily 365-day moving average volatilities. In order to avoid misleadingly frequent changes in rating, however, volatility had to move 2.5 percentage points past the 40% benchmark in either direction for a stock's status to change.

Rating distribution for long-term investment opportunities

As of 30 June 2022, the distribution of all independent ratings published by HSBC is as follows:

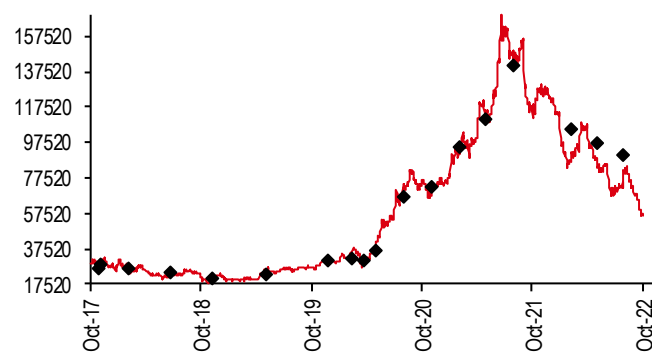
Buy	62%	(18% of these provided with Investment Banking Services in the past 12 months)
Hold	33%	(17% of these provided with Investment Banking Services in the past 12 months)
Sell	5%	(8% of these provided with Investment Banking Services in the past 12 months)

For the purposes of the distribution above the following mapping structure is used during the transition from the previous to current rating models: under our previous model, Overweight = Buy, Neutral = Hold and Underweight = Sell; under our current model Buy = Buy, Hold = Hold and Reduce = Sell. For rating definitions under both models, please see “Stock ratings and basis for financial analysis” above.

For the distribution of non-independent ratings published by HSBC, please see the disclosure page available at <http://www.hsbcnet.com/gbm/financial-regulation/investment-recommendations-disclosures>.

Share price and rating changes for long-term investment opportunities

Kakao (035720.KS) share price performance KRW Vs
HSBC rating history

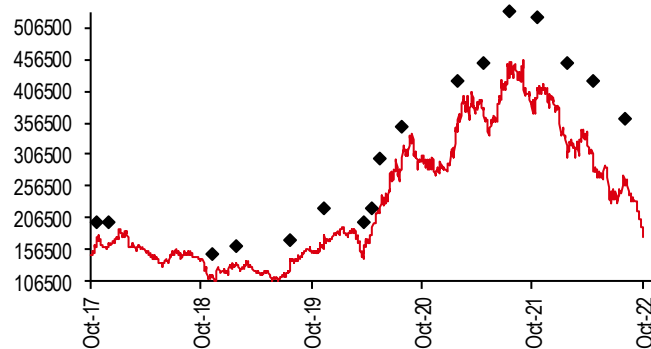


Source: HSBC

Rating & target price history

From	To	Date	Analyst
Reduce	Hold	10 Aug 2017	Jena Han
Target price	Value	Date	Analyst
Price 1	26000	03 Nov 2017	Jena Han
Price 2	28000	09 Nov 2017	Jena Han
Price 3	26000	08 Feb 2018	Jena Han
Price 4	24000	25 Jun 2018	Jena Han
Price 5	20000	09 Nov 2018	Will Cho
Price 6	22000	09 May 2019	Will Cho
Price 7	30000	28 Nov 2019	Will Cho
Price 8	32000	13 Feb 2020	Will Cho
Price 9	30000	27 Mar 2020	Will Cho
Price 10	36000	07 May 2020	Will Cho
Price 11	66000	06 Aug 2020	Will Cho
Price 12	72000	05 Nov 2020	Will Cho
Price 13	94000	09 Feb 2021	Will Cho
Price 14	110000	06 May 2021	Will Cho
Price 15	140000	06 Aug 2021	Will Cho
Price 16	105000	11 Feb 2022	Will Cho
Price 17	97000	04 May 2022	Will Cho
Price 18	90000	04 Aug 2022	Will Cho

Source: HSBC

Naver (035420.KS) share price performance KRW Vs HSBC rating history


Source: HSBC

Rating & target price history

From	To	Date	Analyst
Overweight	Buy	28 Apr 2015	Jena Han
Target price	Value	Date	Analyst
Price 1	170000	22 Jul 2015	Jena Han
Price 2	118000	30 Jul 2015	Jena Han
Price 3	132000	02 Oct 2015	Jena Han
Price 4	144000	29 Oct 2015	Jena Han
Price 5	152000	12 Jan 2016	Jena Han
Price 6	166000	10 Jun 2016	Jena Han
Price 7	170000	24 Jun 2016	Jena Han
Price 8	176000	06 Jul 2016	Jena Han
Price 9	220000	21 Oct 2016	Jena Han
Price 10	200000	26 Jan 2017	Jena Han
Price 11	194000	24 Apr 2017	Jena Han
Price 12	190000	27 Apr 2017	Jena Han
Price 13	198000	26 Oct 2017	Jena Han
Price 14	200000	01 Dec 2017	Jena Han
Price 15	150000	09 Nov 2018	Will Cho
Price 16	160000	31 Jan 2019	Will Cho
Price 17	170000	25 Jul 2019	Will Cho
Price 18	220000	18 Nov 2019	Will Cho
Price 19	200000	27 Mar 2020	Will Cho
Price 20	220000	23 Apr 2020	Will Cho
Price 21	300000	21 May 2020	Will Cho
Price 22	350000	30 Jul 2020	Will Cho
Price 23	420000	28 Jan 2021	Will Cho
Price 24	450000	29 Apr 2021	Will Cho
Price 25	530000	22 Jul 2021	Will Cho
Price 26	520000	21 Oct 2021	Will Cho
Price 27	450000	27 Jan 2022	Will Cho
Price 28	420000	21 Apr 2022	Will Cho
Price 29	360000	05 Aug 2022	Will Cho

Source: HSBC

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Company	Ticker	Recent price	Price date	Disclosure
COUPANG INC	CPNG.N	19.56	04 Oct 2022	7

Source: HSBC

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