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Telecom services

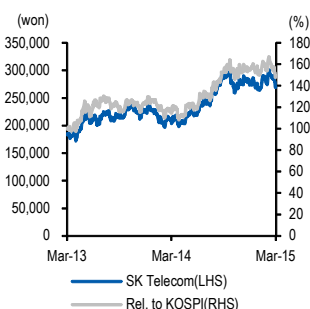
BUY (M)

TP: W380,000 (M)

Share price (won, Mar 12)	270,000
Paid-in capital (Wbn)	45
Market cap (Wbn)	21,801
BPS (won)	206,398
Net debt to equity (%)	36.8
Shares outstanding	80,745,711
Avg daily T/O (2M, Wbn)	41
Avg daily vol (2M, shrs)	147,690
52-week high (won)	301,000
52-week low (won)	198,000
Foreign ownership (%)	44.0
Major shareholders (%)	
SK Holdings Co Ltd & others	25.2

Stock performance (%)

	1M	3M	12M
Absolute	(6.7)	(1.3)	32.7
Relative	(8.1)	(3.7)	30.1
Abs (US\$)	(8.0)	(3.3)	26.1



Quarterly earnings

(Wbn)	1Q15E	% YoY	% QoQ	Consens	vs consens (%)
Sales	4,398	4.7	2.5	4,368	0.7
Operating profit	522	106.9	6.5	536	-2.6
Pre-tax profit	667	100.5	3.0	656	1.7
Net profit	527	95.4	5.2	512	3.0
Op margin (%)	11.9	+5.9 %pt	+0.5 %pt	12.3	-0.4 %pt
Net margin (%)	12.0	+5.6 %pt	+0.3 %pt	11.7	+0.3 %pt

Note: TTB = turn to black, TTR = turn to red, RR = remain in red

Source: Yuanta Securities

SK Telecom (017670 KS)

Possible scenario for SK Group telecom subsidiary restructuring

On SK Group restructuring rumors, scenario of telecom subsidiary restructuring

- Recently, with rumors of a possible merger between SK Holdings and SK C&C, investors are paying attention to the possibility of larger-scale restructuring, including a possible merger of SK Telecom (SKT) and SK Broadband (SKB).

Small scale merger and turnaround

- If SKT and SKB actually merge, a "small scale merger" is possible. According to the revised Commercial Act of Korea in 2014, the requirements for small scale mergers were eased and granting treasury shares was allowed for mergers, split-offs, and stock swaps. With the market cap ratio between SKT and SKB at 1: 0.059, the two can merge simply by exchanging treasury shares, without issuing new stocks. Thus, SKT would not need to hold a shareholders' meeting, and thus, will not face the risk of shareholders exercising appraisal rights. For existing shareholders, this means SKT can acquire SKB without undermining shareholder value. In addition, SKB posted 2014 sales of W2.65tn and operating profit of W58.1bn, as the company saw strong growth in the IPTV market (although net profit is almost nil). In 2016, we expect SKB's net profit to turn around. If a merger takes place, SKT shareholders will be able to share in the benefits of SKB's turnaround. In short, a SKT-SKB merger now is more favorable for SKT shareholders than ever.

Willing to invest in paid broadcasting business

- If SKT merges with SKB, its next target is likely to be C&M. Along with mobile data, the TV platform is the only other growing segment in the telecom industry. Yet, the TV platform business requires investment in network and services, which SKT can handle for C&M. By acquiring C&M, SKT would likely control about 20% of the TV platform market. This would transform the paid broadcasting market's competition dynamics by allowing KT and SKT to pursue qualitative growth rather than destructive competition. Resultantly, investor sentiment on the paid broadcasting market may also improve.

Forecasts and valuations (K-IFRS, consolidated)

	(Wbn)
FY ends Dec	
2012A	2013A
2014E	2015E
Sales	16,141
Operating profit	1,730
Net profit, CI	1,152
% YoY	-28.6
P/E (x)	9.9
P/B (x)	0.8
EV/EBITDA (x)	4.1
ROE (%)	9.8

Note: Operating profit = gross profit - SG&A expense, CI = controlling interest

Source: Yuanta Securities

Recommend SKT for M&A prospects Assuming SKT and SKB merge, we recommend buying SKT for the following reasons:

1) What makes the M&A more plausible is the improved merger ratio. The two firms would not let SKB shares rise because this would deteriorate the ratio. In addition, if the M&A fails to go ahead, there is no risk of SKT shares falling while SKB would likely suffer severe fluctuations.

2) Since the merger would not involve any rights issue, SKT's shareholder value should remain intact. Moreover, SKB is very likely to turnaround in 2016, which would also strengthen SKT shares after a merger.

3) SKT may buy back shares used in the merger process. SK Group has a policy that SKT should maintain treasury shares at a certain level. If more than 2mn treasury shares are given to SKB during the merger, SKT would buy back shares worth W600.0bn. Given DPS of W10,000 and a share buyback program of more than W600.0bn, total shareholder returns for SKT would likely amount to about W1.3tn in 2015.

At his inaugural speech in early 2015, the CEO of SKT strongly emphasized the company's vision of boosting enterprise value to W50tn by 2018. A merger with SKB would be part of efforts to boost enterprise value.

SKT: share structure

Shareholder	Stake (%)	No of shares
SK Holdings	25.22	20,363,452
Treasury share	12.15	9,809,375
Shares outstanding		80,745,711
Market cap (Wbn)		21922.3
Share price (won)		270,000

Source: Yuantia Securities

SKB: share structure

Shareholder	Stake (%)	No of shares
SKT	50.56	149,638,354
Shares outstanding		295,959,087
Market cap (Wbn)		1309.6
Share price (won)		4,455

Source: Yuantia Securities

Likely change in treasury shares for merger

Shares outstanding	80,745,711
SK Holdings	20,363,452
Treasury shares	7,395,083
Decline in treasury shares	2,414,292
(Share buyback program after merger, Wbn)	651.9

Source: Yuantia Securities

SK Telecom (017670 KS) pro forma financial statements (K-IFRS, consolidated)

Statement of comprehensive income					
FY ends Dec (Wbn)	2012A	2013A	2014E	2015E	2016E
Sales	16,141	16,602	17,164	17,850	18,248
Cost of sales	0	0	0	0	0
Gross profit	16,141	16,602	17,164	17,850	18,248
SG&A	14,411	14,591	15,339	15,649	15,904
Operating profit	1,730	2,011	1,825	2,201	2,344
EBITDA	4,343	4,841	4,717	5,122	5,200
Non-op profit/loss	-211	-184	429	363	367
Forex gain/loss	-1	-4	-3	0	0
Net interest inc	-315	-266	-263	-260	-256
Equity-meth gain/loss	-25	707	891	848	848
Other	130	-621	-196	-225	-225
Net prof before income tax	1,519	1,827	2,254	2,564	2,711
Income tax	288	401	454	541	574
Net profit from cont op	1,231	1,426	1,799	2,023	2,137
Net profit from discount op	-115	183	0	0	0
Net profit	1,116	1,610	1,799	2,023	2,137
NP for controlling int	1,152	1,639	1,801	2,025	2,140
Total comprehensive inc	796	1,628	1,772	2,023	2,137
TCI for controlling int	852	1,656	1,780	2,025	2,140

Note: Operating profit calculation same as K-GAAP (sales - COGS - SG&A).

Statement of financial position					
FY ends Dec (Wbn)	2012A	2013A	2014E	2015E	2016E
Current assets	5,294	5,123	5,396	5,932	6,455
Cash & cash equiv	920	1,399	1,312	1,598	2,019
Accts rec & other	2,546	2,913	3,199	3,408	3,491
Inventory	242	177	227	256	264
Non-current assets	20,301	21,453	22,306	22,986	23,732
Tangible assets	9,713	10,197	10,242	10,021	9,865
Investment in affiliate	4,632	5,325	6,242	7,131	8,021
Other non-current	1,076	1,076	1,129	1,131	1,133
Total assets	25,596	26,577	27,702	28,918	30,187
Current liabilities	6,175	6,069	5,902	5,876	5,824
Accts payable & other	3,673	3,796	3,471	3,573	3,650
ST financial liabilities	600	260	677	567	457
Liquid LT liabilities	893	1,268	1,132	1,102	1,072
Non-current liabilities	6,566	6,341	6,508	6,324	6,141
LT financial liabilities	369	105	125	125	125
Debentures	4,979	4,906	5,011	4,811	4,611
Total liabilities	12,741	12,410	12,409	12,200	11,965
Equity, controlling int	11,855	13,452	14,526	15,884	17,314
Paid-in capital	45	45	45	45	45
Capital surplus	2,916	2,916	2,916	2,916	2,916
Retained earnings	12,125	13,102	14,218	15,576	17,006
Equity, non-control int	1,000	714	767	835	908
Total equity	12,855	14,167	15,293	16,719	18,223
Net debt	5,338	4,750	5,349	4,716	3,947
Total debt	6,927	6,646	7,129	6,789	6,449

Cash flow statement					
FY ends Dec (Wbn)	2012A	2013A	2014E	2015E	2016E
Operating cash flow	4,000	3,559	3,380	3,320	3,472
Net profit	1,116	1,610	1,799	2,023	2,137
Depreciation & amort	2,613	2,830	2,892	2,921	2,856
Forex gain/loss	1	-2	-2	0	0
Affiliate invest gain/loss	0	0	-324	-848	-848
Inc(dec) net working cap	204	-970	-627	-247	-140
Other	66	91	-358	-528	-533
Investing cash flow	-5,310	-2,506	-3,110	-2,962	-2,961
Investment	-3,052	67	-21	-42	-42
Inc in tangible assets	-3,394	-2,879	-2,887	-2,700	-2,700
Dec in tangible assets	271	13	19	0	0
Other	865	293	-222	-220	-219
Financing cash flow	585	-573	-498	-1,280	-1,315
Inc(dec) in ST fin liab	-61	-340	414	-110	-110
Inc(dec) in LT fin liab	1,248	33	40	-230	-230
Inc(dec) in equity	0	0	0	0	0
Cash dividend	-655	-656	-667	-667	-709
Other	53	390	-285	-273	-266
Other cash flow	-6	0	142	1,207	1,225
Inc (dec) in cash & eq	-731	479	-86	286	421
Beginning cash & equiv	1,651	920	1,399	1,312	1,598
Ending cash & equiv	920	1,399	1,312	1,598	2,019
NOPLAT	173	201	183	220	234
FCF	825	551	834	1,710	1,864

Valuation					
FY ends Dec	2012A	2013A	2014E	2015E	2016E
EPS (won)	14,263	20,298	22,307	25,076	26,497
BPS (won)	170,095	189,640	204,776	223,919	244,080
EBITDA/shr (won)	53,787	59,952	58,413	63,431	64,394
SPS (won)	199,904	205,609	212,566	221,062	225,996
DPS (won)	9,400	9,400	9,400	10,000	10,000
P/E (x)	9.9	10.1	12.1	10.8	10.2
P/B (x)	0.8	1.1	1.3	1.2	1.1
EV/EBITDA (x)	4.1	4.6	5.9	5.3	5.1
PSR (x)	0.7	1.0	1.3	1.2	1.2

Key financial data					
FY ends Dec	2012A	2013A	2014E	2015E	2016E
Sales (% YoY)	1.3	2.9	3.4	4.0	2.2
Operating profit (%YoY)	-24.6	16.2	-9.3	20.6	6.5
NP, CI (%YoY)	-28.6	42.3	9.9	12.4	5.7
Gross margin (%)	100.0	100.0	100.0	100.0	100.0
Operating margin (%)	10.7	12.1	10.6	12.3	12.8
NP, CI margin (%)	7.1	9.9	10.5	11.3	11.7
EBITDA margin (%)	26.9	29.2	27.5	28.7	28.5
ROIC (%)	10.9	11.8	10.6	12.4	13.3
ROA (%)	4.6	6.3	6.6	7.2	7.2
ROE (%)	9.8	13.0	12.9	13.3	12.9
Debt-to-equity (%)	99.1	87.6	81.1	73.0	65.7
Net debt-to-equity (%)	45.0	35.3	36.8	29.7	22.8
OP/financing cost (x)	4.2	6.1	5.6	6.9	7.3

Note: EPS, BPS, P/E and P/B are based on controlling interest

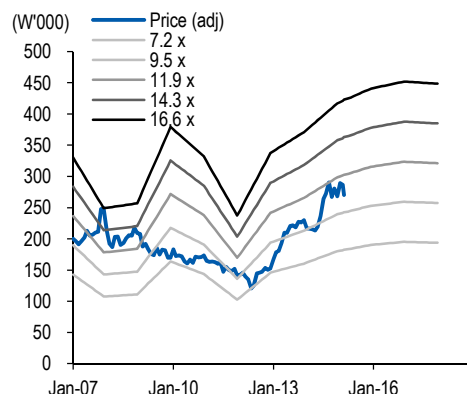
For valuation metrics such as P/E, historical figures are based on annual averages, estimates on current price

For ROA or ROE, assets and equity are averages of end-of-year figures for given year and year prior

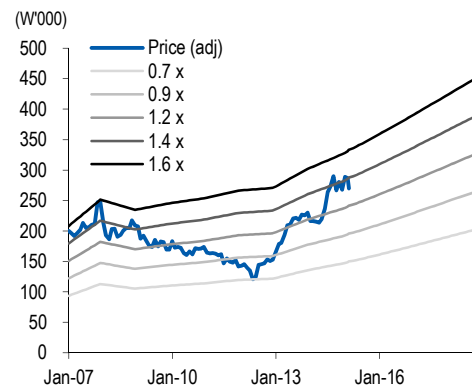
Data to 2010 based on K-GAAP and from 2011, K-IFRS

Source: Yuenta Securities

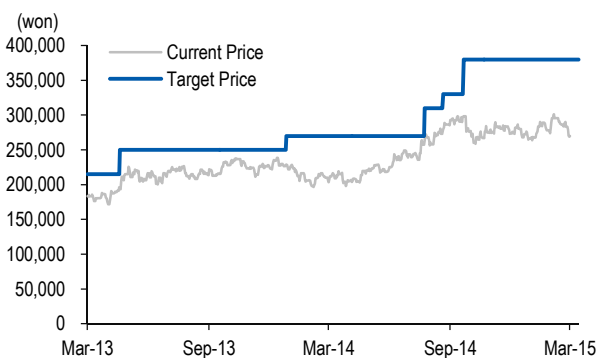
P/E band chart



P/B band chart



SK Telecom (017670 KS) ratings and target price history



Date	Rating	TP (won)
2015/03/13	BUY	380,000
2015/03/09	BUY	380,000
2015/03/09	BUY	380,000
2015/03/02	BUY	380,000
2015/03/02	BUY	380,000
2015/02/23	BUY	380,000
2015/02/09	BUY	380,000
2015/02/02	BUY	380,000
2015/01/30	BUY	380,000
2015/01/28	BUY	380,000

Source: Yuanta Securities

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- **Stock ratings** include an Investment Rating (Strong Buy, Buy, Hold, Sell) based on the expected absolute return of a stock over the next 6 -12 months.
 - Strong Buy: Expected to return 30% or more
 - Buy: Expected to return between 10% and 30%
 - Hold: Expected to return between -10 and +10%
 - Sell: Expected to return -10% or less
- **Sector ratings** suggest 6 to 12 - month forward investment weighting of a given sector compared to its market capitalization weighting.
 - Overweight: Investment weighting is higher than the market capitalization weighting
 - Neutral: Investment weighting is equal to the market capitalization weighting
 - Underweight: Investment weighting is lower than the market capitalization weighting

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