



SHINSEGAE

Shinsegae commenced operations in 1930 and is now the leading retailer in Korea. It pioneered Korea's first hypermarket in 1993 and its first premium outlet mall in 2007.

E-Mart



The E-Mart hypermarket chain is the main business in Shinsegae, accounting for 85% of group earnings. Since inception in 1993 it has established a commanding position in the modern retail sector in Korea, currently operating 115 stores and generating 34% of national hypermarket sales. In the process it has reshaped the retail industry in Korea (previously dominated by department stores and traditional markets) by introducing a new, consumer-oriented shopping culture, and leading a downward trend in retail prices under the principle of everyday low prices. Over the last 10 years the hypermarket store has surpassed the department store as the dominant format in the country.

Hypermarket sales represent about 16.5% of national retail sales in Korea. Other important retail segments include department stores (10%) and the traditional sector which still accounts for over 50% of the national retail sales.

If we include its department stores, Shinsegae's overall share of the national retail dollar in Korea is estimated to be around 7.2%.

As a developed economy with high income per capita and a relatively mature population profile Korea is not an obvious choice for a strong retail growth theme. However half of national retail sales are still generated by traditional 'mom and pop' stores and Shinsegae's E-Mart and other modern retailers have been growing by increasing market share against this traditional sector. The main drivers

behind the swing in market share to modern discount stores are pricing, convenience and the younger generation coming through (traditional market customers tend to be older, while modern retailers attract younger customers). We believe E-Mart has scope to continue growing through market share gain for several years as it builds momentum in the competitive benefits of location, format, process and scale.

Location

Shinsegae realised early on that prime location is a cornerstone of success in retailing. Accordingly it purchased and developed a significant number of key sites. In this regard it has been well ahead of its competitors. Shinsegae owns about 75% of its E-Mart locations, and has secured land for a further 28 stores to be opened in the coming years.

As a result E-Mart has the largest number of stores across the nation, at prime locations in each region. The location of stores is important in this market, as traffic congestion discourages Korean consumers from travelling long distances. E-Mart's positioning in prime locations is one factor that has made it difficult for later entrants like Wal-Mart and Carrefour to gain purchase in the local market. These companies established operations in Korea in the 1990's, but both have now exited.

Format

Another factor in the competitive success of E-Mart has been its ability to develop a Korean style hypermarket, with features such as easy shelf access and a strong offering of fresh local food designed specifically to attract local customers. It is fair to say that Wal-Mart and Carrefour were less successful in attracting customers because they were unable to satisfy the specific needs of Korean shoppers.

Shinsegae acquired 16 Wal-Mart stores in Korea when Wal-Mart decided to exit in 2006. The sales of these stores improved materially once their name was changed to E-Mart, and their formats were



modified along E-Mart lines. Shinsegae plans to merge formally with the former holding company for Wal-Mart in Korea, which will make way for a full integration of supply chain and back office functions.

Process

Shinsegae is progressing well in the modernisation of its supply chain. 65% of goods sold now come through six logistics centres. It opened the world's largest logistics centre (75,286 sq. m.) in July 2008.



Scale

Thanks to its scale and market position, Shinsegae enjoys strong purchasing power with its suppliers. It also has the scale to use its purchasing power beyond the borders of Korea, sourcing merchandise from several countries around the world. Another advantage of scale is the ability to introduce private labels, which is beneficial for operating margins. At this stage private label products represent 17% of E-Mart's Korean sales. This is targeted to reach 30% by 2010. Both global sourcing and home brands are at an early stage of development when compared with hypermarkets in other countries.

Competition

E-Mart's competitors in the modern hypermarket sector in Korea are Lotte Shopping's Lotte Mart and Samsung Tesco's Home Plus. In May 2008, Samsung Tesco acquired Home Ever, formerly Carrefour Korea. If the acquisition is approved by regulators, Tesco will run 102 stores, which is a close second to E-Mart's 115 stores.

China

E-Mart has also been laying the foundations for longer term growth by establishing a chain of E-Mart stores in China. It opened the first store in China 11

years ago and there are now 14 E-Marts operating in Eastern China. The Chinese operation is expected to reach break-even next year, and is planning to open about seven new stores per annum. Management's target is to have at least 70 stores operating by 2012. By this stage China is expected to be making a meaningful contribution to Shinsegae's earnings and to be in a position to become a material engine of growth for the group in the longer term.

Department Stores

Shinsegae began life in 1930 as a department store. This is still an important business for the group, contributing 15% of operating earnings. Shinsegae is the third largest department store chain in Korea, with seven stores. It plans to add more than three new department stores to its network by 2012. A new store is scheduled to be opened in Centum City, Busan in March 2009, and new store openings are planned in other major cities. Shinsegae's strategy is to make each department store the prime store in its region.

Other Assets in the Group

Stake in Samsung Life Insurance

Shinsegae is the largest shareholder of Samsung Life Insurance, the largest insurance company in Korea, with a stake of 13.6%.

Joint Ventures

Shinsegae has joint ventures with some of the world's leading brands such as Starbucks Coffee International, Chelsea Property Group and the Starwood (Westin) hotel chains. In particular, the joint venture with Starbucks has been very successful.



Online Retailing

Shinsegae established mid- and long-term development models for its online business. Shinsegae runs two online malls: Shinsegae mall and E-Mart mall. The online operation generates sales of W200bn and is growing strongly.

Financial Position

Shinsegae's policy of owning key store sites has resulted in a degree of debt funding, whereby interest replaces rent as an operating cost.

Whilst we are generally wary of debt funding in companies, we consider the financial leverage in Shinsegae to be reasonable:

- Shinsegae enjoys a high positive leverage index—i.e. return of capital employed is more than twice the cost of debt
- Operating profit covers interest expenditure five and a half times
- Net debt of W3.6trn (US\$3.3bn) sits against the historical book value of land and buildings of W5trn and an after tax value of Shinsegae's stake in Samsung Life Insurance of W1.1trn (based on the informal OTC market price).

Shinsegae's ROE is currently running at 16.2%.

Conclusion



As a pioneer in Korean retailing Shinsegae exhibits many of the qualities we look for in a company. Management has demonstrated good foresight in acquiring prime sites early on, and good understanding of local market conditions in developing stores that cater to Korean tastes. The company is now competitively positioned to continue growing market share by building on the advantages it has established in location, format, process and

scale. Many of these benefits flow through to its customers in the form of lower prices, range and quality of merchandise, and overall quality of shopping experience (e.g. convenience).

We believe the above advantages provide Shinsegae with considerable scope to continue growing market share against traditional sector operators. Beyond this the initiative to replicate E-Mart in China is well progressed and provides a degree of 'optionality' to the longer term value of Shinsegae.