

Dongsun Finetec (033500)

BUY (Maintain), TP W10,000 (Up)

Stock price (Feb 27, KRW)	7,210
Market cap (USD mn)	172
Shares outstanding (mn)	27
52W High/Low (KRW)	7,620/4,160
6M avg. daily turnover (USD mn)	1.1
Free float (%)	58.1
Foreign ownership (%)	2.2
Major shareholders (%)	
Dongsung Corporation and 2 others	40.6
Beig Asset Management Korea Co., Ltd and 2 others	5.0

Yr to	Sales	OP	NP	EPS	% chg	EBITDA	PE	EV/EBITDA	PB	ROE	DY
Dec	(W bn)	(W bn)	(W bn)	(KRW)	(YoY)	(W bn)	(x)	(x)	(x)	(%)	(%)
2014A	421	25	24	871	NM	32	9.0	9.7	2.0	22.8	1.7
2015A	347	20	14	531	(39.0)	27	9.1	8.6	1.1	13.1	2.7
2016F	321	20	12	442	(16.8)	26	13.0	9.4	1.3	10.0	2.3
2017F	282	10	5	191	(56.7)	16	37.7	17.8	1.6	4.2	1.8
2018F	340	20	15	545	185.1	26	13.2	10.8	1.4	11.3	1.8

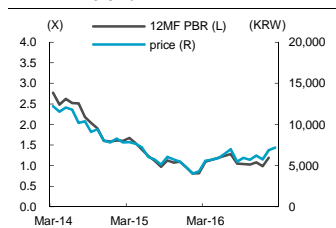
Note: NP in equity-method accounting

Downstream inflection point is always right

Performance

	1M	6M	12M
Absolute (%)	3.4	22.8	73.3
Rel. to Kospi (p.p)	3.4	20.5	64.7

12MF PB trend



Lift TP to W10,000: We lift our TP for Dongsung Finetec (Dongsung) from W7,000 to W10,000 (2x mid-cycle PB). We changed the TP calculation method from PE to PB valuation. Given the sluggish LNG carrier orders at shipbuilders over the past two years, Dongsung will likely continue to deliver poor earnings through 2017. But LNG carrier orders should rise from 2017 and this would lead to more work and bigger sales for cryogenic insulation makers. For order-driven industries, profits are very volatile and it is hard to figure out when exactly orders would materialize. As such, from a turnaround perspective among downstream industries, we believe it would be more meaningful to calculate the TP using PB valuation. As Dongsung rules the global cryogenic insulation market with Hankuk Carbon, recovery signals for the downstream industries would provide a good entry point.

Coming upcycle to be more favorable for cryogenic insulation market:

According to KIS' shipbuilding sector supply-demand model, the LNG carrier market struck a supply-demand balance in 2016 and LNG carrier tenders are expected to resume from 2017. It is estimated that Korea's Big 3 shipyards will win orders for 27 LNG carriers in 2017 and 30 in 2018, up sharply from just seven ships secured in 2016. In particular, Hyundai Heavy Industries (HHI) and Samsung Heavy Industries (SHI) are poised to lead the market's recovery going forward. Daewoo Shipbuilding & Marine Engineering (DSME) would have limited capacity for more work as it is swamped from taking orders for 37 LNG carriers in 2014 and also given its recent operating environment. Shipbuilders use different types of cryogenic insulation, and for Dongsung, orders received from SHI or HHI can be worth up to W22bn per ship while orders from DSME are worth W2bn-8bn. It takes six to 12 months for shipbuilders to place orders for cryogenic insulation after receiving their ship order. Therefore, Dongsung's orders should stay relatively flat YoY at W100bn in 2017 but should soar to W253bn in 2018.

Earnings to hit bottom in 2017: As the orders backlog shrank in 2015-2016 due to the sluggish downstream industry, Dongsung's earnings will likely remain weak in 2017. For 2017, we estimate sales at W282.1bn (-12.2% YoY) and OP at W9.8bn (-50.1% YoY) with an OPM of 3.5%. Among cryogenic insulation installed for LNG carriers, lucrative insulation panel sales should plummet in the orders backlog, leading to sharp OPM erosion in 2017. But if Dongsung wins new LNG carrier-related orders this year, the insulation panel sales weighting would start rising from 2018, lifting sales 20% YoY and OPM 2.3%p to 5.8% in the year.

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US, land of opportunity: Dongsung established a manufacturing plant in a 50:50 joint venture with LandCoast (US specialist in insulation, paints, flame-retardant materials and fireproofing) in Louisiana. Dongsung aims to participate in the country's shale gas projects with its pipe insulation expertise. In Louisiana, a total of ~USD70bn natural gas/chemical projects are underway in Lake Charles and around the Gulf Coast. Six projects so far have won government approval, which together create a cryogenic insulation market worth USD970mn, according to Dongsung. Dongsung hopes to win orders from the US shale gas projects by taking advantage of LandCoast's marketing power.


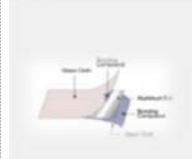
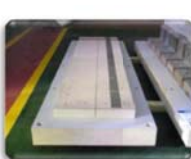


Table 18. Earnings estimates

(W bn, %)

	1Q16	2Q16	3Q16	4Q16F	1Q17	2Q17	3Q17	4Q17	2015	2016F	2017F	2018F
Sales	103.0	83.8	65.5	68.8	76.0	68.3	60.0	77.9	347.1	321.2	282.1	339.7
Cryogenic	81.2	56.6	41.3	39.5	53.7	40.1	35.3	47.2	254.7	218.7	176.3	227.7
Offshore	78.9	55.4	40.6	38.6	51.3	38.8	34.5	46.2	251.2	213.5	170.8	222.0
Onshore	2.3	1.2	0.7	0.9	2.4	1.3	0.8	1.0	3.5	5.2	5.5	5.6
Non-cryogenic	21.8	27.2	24.3	29.3	22.3	28.2	24.7	30.7	94.5	102.5	105.9	112.1
Polyurethane	3.3	3.8	3.7	4.0	2.8	3.2	3.2	4.1	19.8	14.8	13.4	15.4
Metal panel	13.2	17.2	14.5	19.6	13.9	18.2	15.1	20.5	53.8	64.5	67.7	71.1
Fire-extinguishing	1.4	1.1	1.4	1.7	1.3	1.1	1.3	1.7	6.2	5.6	5.4	5.2
Refrigerants	3.9	5.1	4.7	4.0	4.2	5.7	5.2	4.3	14.7	17.6	19.4	20.3
OP	7.8	4.7	3.6	3.6	3.0	2.4	1.5	2.9	20.4	19.7	9.8	19.8
OPM	7.5	5.6	5.6	5.2	4.0	3.5	2.5	3.7	5.9	6.1	3.5	5.8
New orders									189.1	103.0	99.9	253.0
Backlog									348.6	232.9	156.5	181.8

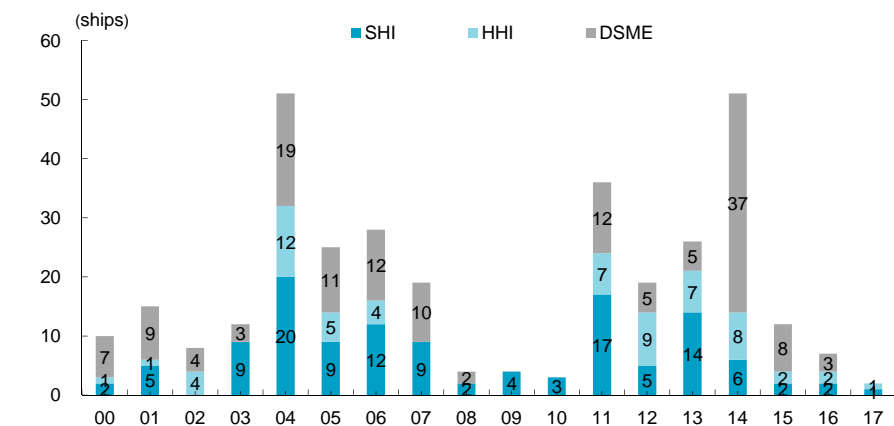
Source: Korea Investment & Securities

Table 19. Main cryogenic insulation products: Dongsung can win orders worth ~W20bn per LNG carrier

Category	R-PUF	Triplex	Insulation panel	Membrane	Pipe insulation
Image					
Description	- A highly compressed glass fiber reinforced polyurethane foam to withstand the impact of wind and waves - A component of the insulation panel	- Secondary barrier - Made using fiber glass	- Actual cryogenic insulation using R-PUF featured in the cargo hold of LNG vessels	- Core material in LNG storage and transport equipment that is used as the primary barrier that withstands the shrinkage stress and impact from the extreme low temperatures when exposed to direct contact with LNG	- Insulation for pipes installed within pipes to prevent the gasification of liquefied natural gas - Also widely used in FLNG equipment
Companies	- Hankuk Carbon, Dongsung	- Hankuk Carbon	- Hankuk Carbon, Dongsung	- Dongsung, TMC	- Dongsung, Kangrim
Value per vessel		W13bn-15bn per panel W4bn-4.5bn for R-PUF		W4bn-4.5bn	W2.5bn
Dongsung	Available	Not available	Available	Available	Available
Hankuk Carbon	Available	Available	Available	Not available	Available (Lacks references)

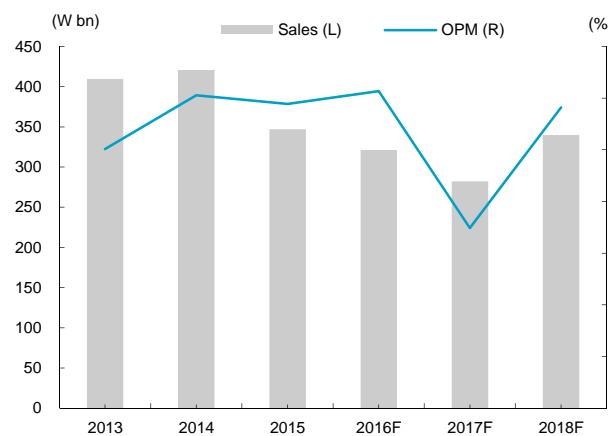
Source: Dongsung, Korea Investment & Securities

Figure 53. LNG carrier orders outlook



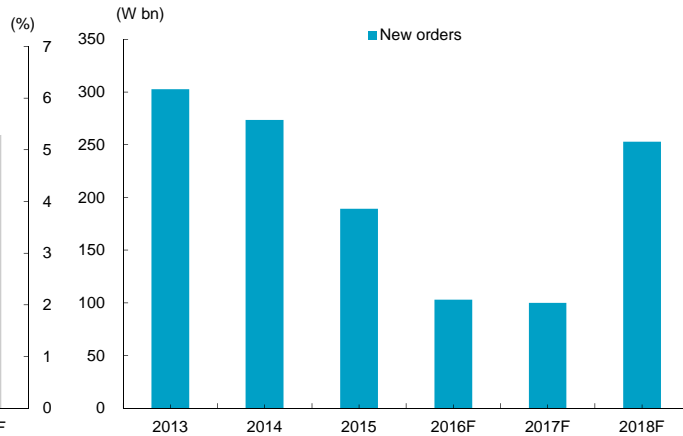
Source: Korea Investment & Securities

Figure 54. Annual earnings



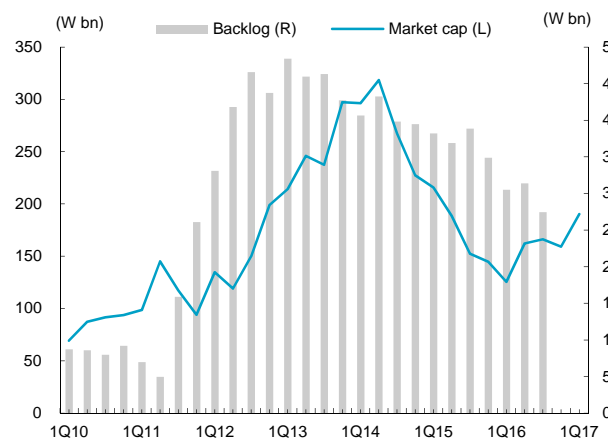
Source: Company data, Korea Investment & Securities

Figure 55. New orders



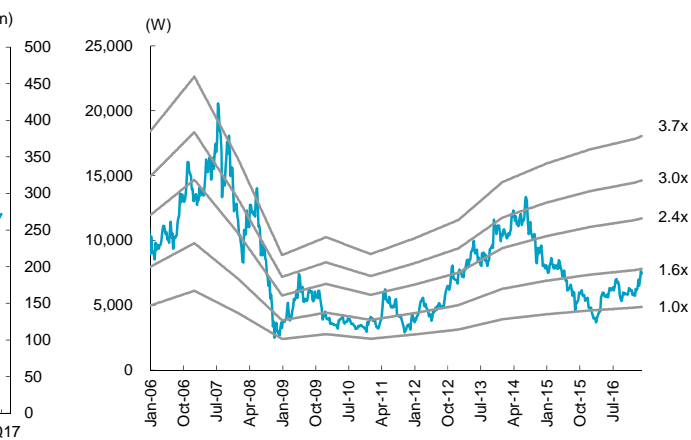
Source: Company data, Korea Investment & Securities

Figure 56. Backlog and market cap



Source: Company data, Korea Investment & Securities

Figure 57. PB band



Source: Korea Investment & Securities

Glossary

- Cryogenic insulation: Refers to using insulating material for the purpose of preventing heat from coming into a low-temperature space. Often also needs to be water and moisture resistant. The cryogenic insulation products manufactured by Dongsung are used in the storage tanks of LNG carriers that transport LNG at -162°C
- Insulation panel: Actual cryogenic insulation using R-PUF featured in the cargo hold of LNG carriers
- Membrane: Core material in LNG storage and transport equipment that is used as the primary barrier that withstands the shrinkage stress and impact from the extreme low temperatures when exposed to direct contact with LNG
- Pipe insulation: Insulation for pipes installed within pipes to prevent the gasification of liquefied natural gas; Also widely used in FLNG equipment

Balance sheet

FY-ending Dec. (W bn)	2014A	2015A	2016F	2017F	2018F
Current assets	141	145	141	142	171
Cash & cash equivalents	10	5	10	10	12
Accounts & other receivables	61	65	71	73	88
Inventory	68	71	58	56	68
Non-current assets	140	137	132	130	132
Investment assets	4	5	5	4	5
Tangible assets	129	126	121	121	121
Intangible assets	2	2	2	2	2
Total assets	281	282	273	272	303
Current liabilities	150	110	125	125	143
Accounts & other payables	48	42	39	31	37
ST debt & bonds	92	42	53	53	53
Current portion of LT debt	0	20	31	31	31
Non-current liabilities	28	59	26	25	27
Debentures	0	0	0	0	0
LT debt & financial liabilities	20	50	18	18	18
Total liabilities	178	169	152	150	170
Controlling interest	103	113	121	123	133
Capital stock	14	14	14	14	14
Capital surplus	43	43	43	43	43
Other reserves	(3)	(3)	(3)	(3)	(3)
Retained earnings	49	59	68	69	80
Minority interest	0	0	(0)	(0)	(0)
Shareholders' equity	103	113	121	123	133

Cash flow

FY-ending Dec. (W bn)	2014A	2015A	2016F	2017F	2018F
C/F from operations	34	5	23	10	13
Net profit	24	14	12	5	15
Depreciation	6	6	6	6	6
Amortization	0	0	0	0	0
Net incr. in W/C	(1)	(21)	1	(2)	(7)
Others	4	5	4	1	(0)
C/F from investing	(11)	(5)	(5)	(7)	(8)
Capex	(10)	(5)	(4)	(6)	(6)
Decr. in fixed assets	0	2	2	0	0
Incr. in investment	(1)	(1)	(4)	(1)	(0)
Net incr. in intangible assets	(1)	(0)	(0)	(0)	(1)
Others	0	(0)	0	0	(1)
C/F from financing	(17)	(5)	(13)	(3)	(3)
Incr. in equity	0	0	0	0	0
Incr. in debt	(15)	(1)	(10)	0	0
Dividends	(2)	(3)	(3)	(3)	(3)
Others	0	(0)	0	0	0
C/F from others	0	0	0	0	0
Increase in cash	5	(4)	4	(0)	2

Note: K-IFRS (consolidated)

Income statement

FY-ending Dec. (W bn)	2014A	2015A	2016F	2017F	2018F
Sales	421	347	321	282	340
COGS	369	304	279	252	297
Gross profit	52	43	42	30	42
SG&A expenses	27	23	22	20	23
Operating profit	25	20	20	10	20
Financial income	0	0	0	0	0
Interest income	0	0	0	0	0
Financial expenses	5	3	5	2	2
Interest expenses	5	3	3	2	2
Other non-operating profit	(1)	0	4	0	0
Gains (Losses) in associates, subsidiaries and JV	(0)	(0)	(4)	(1)	1
Earnings before tax	20	17	15	6	18
Income taxes	(4)	3	3	1	4
Net profit	24	14	12	5	15
Net profit of controlling interest	24	14	12	5	15
Other comprehensive profit	(0)	(0)	(0)	(0)	(0)
Total comprehensive profit	23	14	11	5	14
Total comprehensive profit of controlling interest	23	14	11	5	14
EBITDA	32	27	26	16	26

Key financial data

FY-ending Dec.	2014A	2015A	2016F	2017F	2018F
Per-share data (KRW)					
EPS	871	531	442	191	545
BPS	3,919	4,303	4,600	4,649	5,048
DPS	130	130	130	130	130
Growth (%)					
Sales growth	NM	(17.5)	(7.5)	(12.2)	20.4
OP growth	NM	(19.8)	(3.6)	(50.1)	100.9
NP growth	NM	(39.8)	(16.8)	(56.7)	185.1
EPS growth	NM	(39.0)	(16.8)	(56.7)	185.1
EBITDA growth	NM	(16.3)	(2.0)	(37.3)	60.5
Profitability (%)					
OP margin	6.1	5.9	6.1	3.5	5.8
NP margin	5.6	4.1	3.7	1.8	4.3
EBITDA margin	7.6	7.7	8.2	5.8	7.8
ROA	8.4	5.0	4.2	1.9	5.0
ROE	22.8	13.1	10.0	4.2	11.3
Dividend yield	1.7	2.7	2.3	1.8	1.8
Dividend payout ratio	14.7	24.5	29.4	68.0	23.8
Stability					
Net debt (W bn)	103	106	92	92	90
Debt/equity ratio (%)	109.2	98.5	83.7	82.8	76.1
Valuation (x)					
PE	9.0	9.1	13.0	37.7	13.2
PB	2.0	1.1	1.3	1.6	1.4
EV/EBITDA	9.7	8.7	9.4	17.8	10.8

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