

Sung Kwang Bend (014620)

Above

In line

Below

12M rating **Hold (Maintain)**

Hopes must turn into reality

Stock Data

KOSPI (May 9, pt)	1,968
Stock price (May 9, KRW)	10,850
Market cap (USD mn)	266
Shares outstanding (mn)	29
52-Week high/low (KRW)	15,150/7,450
6M avg. daily turnover (USD mn)	3.4
Free float / Foreign ownership (%)	56.5/16.2
Major shareholders (%)	
Jae-Il Ahn and 6 others	41.1

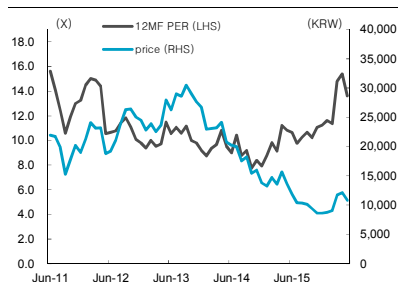
Valuation

	2015A	2016F	2017F
PE (x)	12.4	30.1	21.2
PB (x)	0.5	0.6	0.6
ROE (%)	4.2	2.2	3.0
EV/EBITDA (x)	8.5	14.6	11.5
EPS (KRW)	696	361	512
BPS (KRW)	16,625	16,831	17,185

Performance

	1M	6M	12M
Absolute (%)	(13.9)	17.0	(28.4)
Relative to KOSPI (%p)	(13.7)	19.9	(22.7)

12MF PER trend



Source: WISEfn consensus

What's new: Poor OP

Sung Kwang Bend (SK Bend) posted weak 1Q16 results with consolidated sales of W54.8bn and OP of W2.8bn (OPM 5.1%). Sales fell 14% YoY, or 12.3% QoQ, while OP plunged 54% YoY, or 29% QoQ. In particular, OP missed consensus by 46.2% as weaker sales stemming from sluggish orders in 2H15 (W46.5bn in 3Q15 and W68.9bn in 4Q15 on a consolidated basis) led to a heavier fixed cost burden. Moreover, the weighting of lucrative offshore plant volume in the total backlog shrank while the carbon-based product weighting increased, and this mostly catalyzed the OPM erosion. As FX valuation losses of ~W800mn were booked, EBT reached W2.1bn and NP W1.6bn.

Pros: Anticipating EPC orders for domestic builders

Domestic engineering, procurement and construction (EPC) companies should secure more refinery orders from 2H16. With the refining margin normalizing, refinery investments should continue and refinery tenders from the Middle East should rise 34% YoY in 2016. Starting from 2016, Korean EPC players are set to step up competition to secure projects from the Middle East. Accordingly, there are hopes for a significant YoY growth in EPC orders. But even if domestic EPC firms win orders in 2H16, it would take nine to 12 months to place fittings tenders. As such, the orders should have a marginal impact on sales and profits for fittings makers.

Cons: More challenges to win shipbuilding orders (offshore plants)

Offshore plant conditions for shipbuilders have yet to emerge from a slump. A simple example is the much smaller order pool at equipment/parts makers after the Shell FLNG project (hull side order worth USD4.7bn) won by Samsung Heavy Industries was cancelled early this year. According to Norwegian energy consulting firm Rystad, the BEP oil price for an offshore plant project is USD60-70 (Brent crude basis), meaning that the current oil price range is not enough to restore an uptrend in offshore plant projects. As a result, orders bound for industrial plants (carbon-based products) should rise from 2H16 to 2017, but offshore-related orders should decline.

Conclusion: Shares sensitive to oil, but builders need large-scale EPC for structural growth

We maintain Hold on SK Bend. Sales and OP should shrink YoY in 2016. Oil prices bottomed out from earlier in the year before rising slightly, and shares also rallied

(W bn, %, %p)

	1Q16P				Change		2016F	
	KIS est.	Actual	Diff.	Consensus	QoQ	YoY	KIS	Consensus
Sales	56.4	54.8	(2.9)	60.0	(12.3)	(14.0)	231.4	251.6
OP	5.2	2.8	(46.2)	5.3	(28.9)	(53.7)	14.0	24.6
OP margin	9.2	5.1	(4.1)	8.8	(1.2)	(4.3)	6.1	9.8
EBT	5.4	2.1	(61.5)	NA	(28.3)	(66.6)	13.3	NA
NP	4.1	1.6	(61.5)	4.0	(29.2)	(62.9)	10.1	20.8

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Chulhee Cho

822-3276-6189

chulhee.cho@truefriend.com

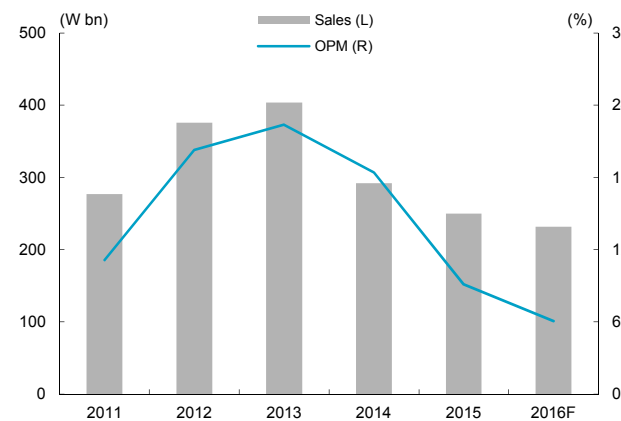
25% YoY on hopes for downstream improvements. Shares currently trade at 30x 2016F PE and 21x 2017F PE, preemptively pricing in expectations for better EPC orders at domestic builders in 2H16. As such, shares may respond sensitively to oil prices in the short term, but for structural growth, builders need to secure large-scale EPC orders.

Table 1. SK Bend quarterly earnings

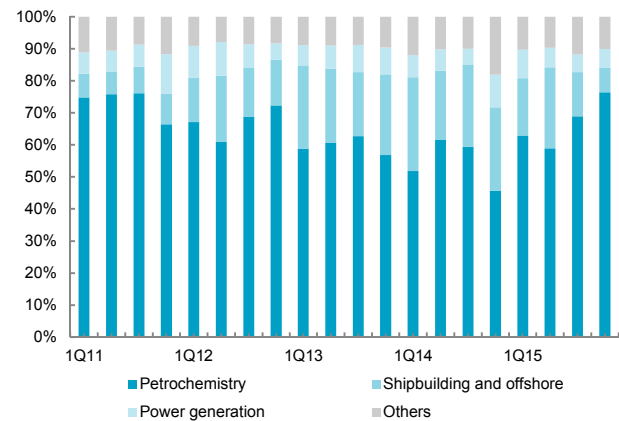
(W bn, %)

	2015				2016F				15	16F
	1Q	2Q	3Q	4Q	1QP	2QF	3QF	4QF		
Sales	63.7	63.8	59.9	62.5	54.8	57.8	58.5	60.2	249.9	231.4
OP	6.0	7.0	5.8	3.9	2.8	3.2	4.0	4.0	22.8	14.0
NP	4.2	6.2	6.7	2.2	1.6	2.3	2.9	3.3	19.5	10.1
OPM	9.4	11.0	9.7	6.3	5.1	5.5	6.9	6.7	9.1	6.1
NPM	6.7	9.8	11.3	3.6	2.9	3.9	5.0	5.5	7.8	4.4
Orders	73.8	59.2	46.5	68.9	45.0				214.7	216.9
Sales chg. (YoY)	(20.7)	(19.6)	(14.5)	0.5	(14.0)	(9.3)	(2.3)	(3.6)	(14.4)	(7.4)
OP chg. (YoY)	(69.3)	(58.2)	(53.0)	(21.4)	(53.3)	(54.7)	(30.6)	2.6	(57.6)	(38.4)
NP chg. (YoY)	(73.0)	(39.5)	(40.6)	(65.3)	(63.1)	(63.9)	(56.6)	50.2	(52.4)	(50.3)

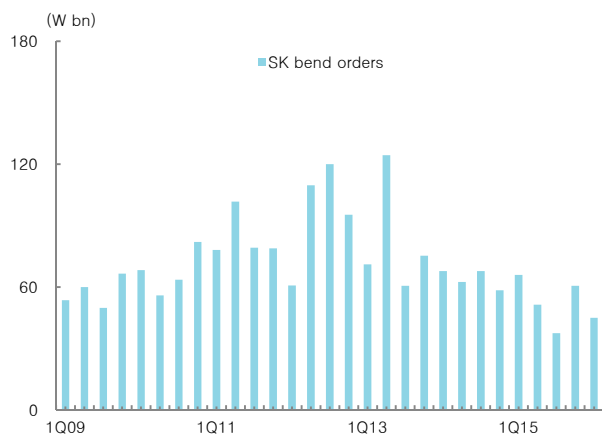
Source: Korea Investment & Securities

Figure 1. Annual earnings trend

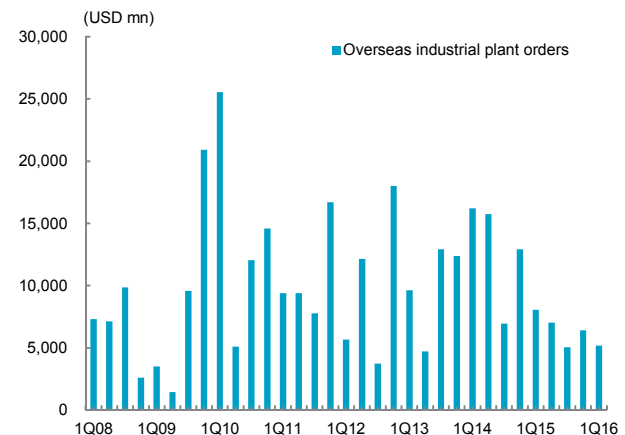
Source: Korea Investment & Securities

Figure 2. Downstream-bound sales breakdown

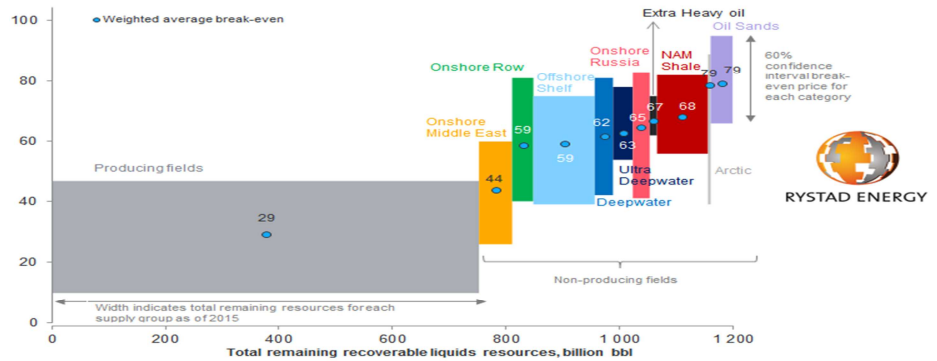
Source: Korea Investment & Securities

Figure 3. Orders trend (separate)

Source: Company data, Korea Investment & Securities

Figure 4. Overseas industrial plant orders

Source: International Contractors Association of Korea, Korea Investment & Securities

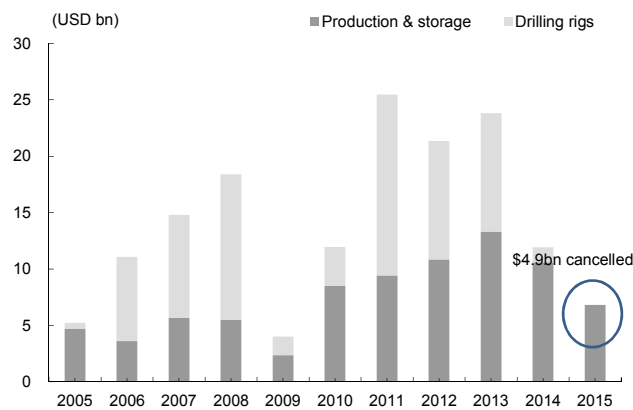
Figure 5. Break-even point by global E&P project – USD60-70 for offshoreGLOBAL LIQUIDS COST CURVE*
Real Brent USD/bbl

*The break-even price is the Brent oil price at which NPV equals zero using a real discount rate of 7.5%. Resources are split into two life cycle categories: producing and non-producing (under development and discoveries). The latter is further split into several supply segment groups. The curve is made up of more than 20,000 unique assets based on each asset's break-even price and remaining liquids resources in 2015.

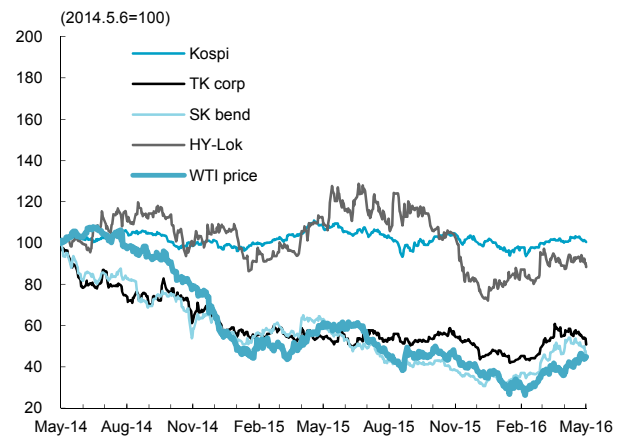
Source: Rystad Energy UCube September 2015

Note: The break-even price is the Brent oil price at which NPV equals zero using a real discount rate of 7.5%

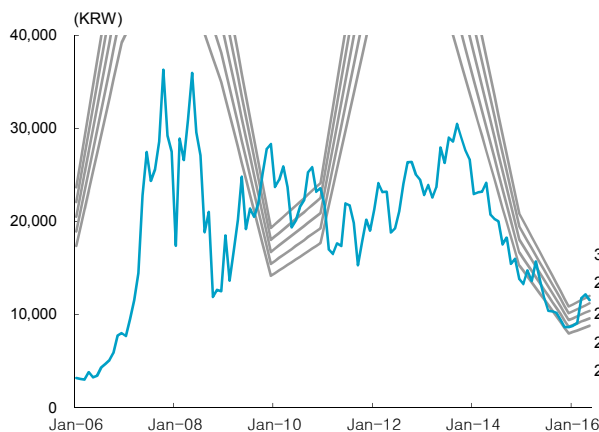
Source: Korea Investment & Securities

Figure 6. Big 3 shipyards' offshore plant orders (nearly zero considering SHI's project cancellation in 2015)

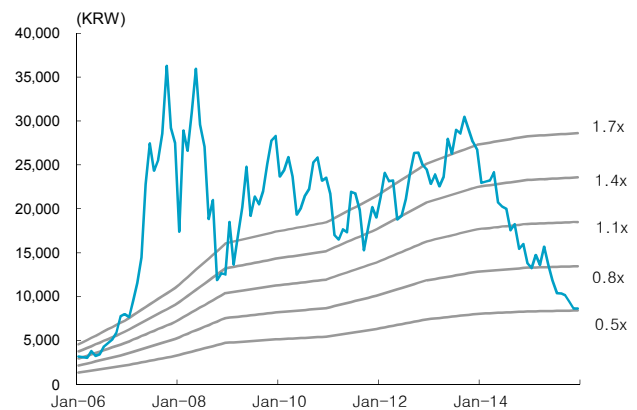
Source: Company data, Korea Investment & Securities

Figure 7. Fittings players share performances

Source: Bloomberg, Korea Investment & Securities

Figure 7. PE band

Source: Company data, Korea Investment & Securities

Figure 8. PB band

Source: Company data, Korea Investment & Securities

Company overview & Glossary

Since 1965, SungKwang Bend is one of the world's leading companies in the manufacture of butt-weld pipe fittings for oil & gas, chemicals & petrochemicals, power plants and shipbuilding. SungKwang is fully equipped with two large factories in Busan and supported by accumulated technologies, can supply an extensive product range from 1/2" to 158" for elbows, tees using seamless pipes and steel plates.

- Fitting: Pipe fitting is the core piping component made from pipe and plate by welding or forming by mandrel/molds. Pipe fitting is used for transporting, changing the direction or volume of fluid flow, and furcating from mother pipe.

Balance sheet

FY-ending Dec. (W bn)	2014A	2015A	2016F	2017F	2018F
Current assets	304	271	250	266	273
Cash & cash equivalent	56	39	37	41	44
Accounts & other receivables	77	78	72	82	78
Inventory	163	148	134	136	143
Non-current assets	249	275	282	291	299
Investment assets	3	5	4	5	5
Tangible assets	244	268	276	284	292
Intangible assets	1	1	1	1	1
Total assets	553	546	532	557	572
Current liabilities	50	58	46	62	62
Accounts & other payables	32	27	23	27	29
ST debt & bond	13	6	0	0	0
Current portion of LT debt	0	20	5	0	0
Non-current liabilities	52	22	15	14	14
Debentures	0	0	0	0	0
LT debt & financial liabilities	30	1	0	0	0
Total liabilities	101	80	61	76	77
Controlling interest	452	466	471	482	496
Capital stock	14	14	14	14	14
Capital surplus	4	4	4	4	4
Other Reserves	(10)	(13)	(13)	(13)	(13)
Retained earnings	444	460	466	476	491
Minority interest	0	0	0	0	0
Shareholders' equity	452	466	471	482	496

Cash flow

FY-ending Dec. (W bn)	2014A	2015A	2016F	2017F	2018F
C/F from operating	53	32	37	26	20
Net profit	44	19	10	14	18
Depreciation	3	3	4	4	4
Amortization	0	0	0	0	0
Net incr. in W/C	13	7	24	7	(3)
Others	(7)	3	(1)	1	1
C/F from investing	(12)	(27)	(12)	(13)	(13)
CAPEX	(11)	(26)	(12)	(12)	(12)
Decr. in fixed assets	0	0	0	0	0
Incr. in investment	(1)	1	0	(0)	(0)
Net incr. in intangible assets	0	0	(0)	(0)	(0)
Others	0	(2)	0	(1)	(1)
C/F from financing	(13)	(24)	(26)	(10)	(4)
Incr. in equity	0	0	0	0	0
Incr. in debts	15	(16)	(22)	(5)	0
Dividends	(4)	(4)	(4)	(4)	(4)
Others	(24)	(4)	0	(1)	0
C/F from others	0	1	0	0	0
Increase in cash	28	(17)	(2)	4	3

Note: Based on K-IFRS (consolidated)

Income statement

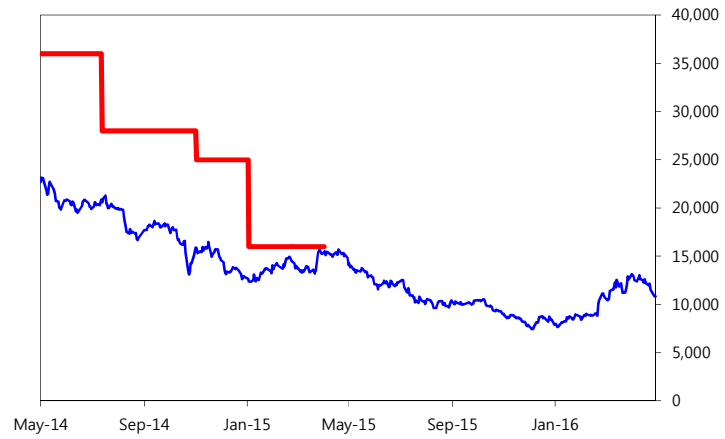
FY-ending Dec. (W bn)	2014A	2015A	2016F	2017F	2018F
Sales	292	250	231	248	260
COGS	208	194	187	198	203
Gross profit	84	56	45	50	57
SG&A expense	30	33	31	31	33
Operating profit	54	23	14	19	24
Financial income	1	1	0	0	0
Interest income	1	0	0	0	0
Financial expense	1	1	1	0	0
Interest expense	1	1	0	0	0
Other non-operating profit	4	4	0	0	0
Gains (Losses) in associates, subsidiaries and JV	0	0	0	0	0
Earnings before tax	57	26	13	19	24
Income taxes	13	7	3	5	6
Net profit	44	19	10	14	18
Net profit of controlling interest	44	19	10	14	18
Other comprehensive profit	(1)	1	0	0	0
Total comprehensive profit	43	20	10	14	18
Total comprehensive profit of controlling interest	43	20	10	14	18
EBITDA	57	26	18	22	28

Key financial data

FY-ending Dec.	2014A	2015A	2016F	2017F	2018F
per share data (KRW)					
EPS	1,536	696	361	512	659
BPS	16,062	16,625	16,831	17,185	17,682
DPS	150	150	150	150	150
Growth (%)					
Sales growth	(27.6)	(14.4)	(7.4)	7.0	5.0
OP growth	(40.6)	(57.6)	(38.4)	32.0	28.5
NP growth	(35.8)	(55.6)	(48.1)	41.8	28.6
EPS growth	(35.6)	(54.7)	(48.1)	41.8	28.6
EBITDA growth	(38.8)	(53.9)	(32.6)	26.2	24.3
Profitability (%)					
OP margin	18.4	9.1	6.1	7.5	9.2
NP margin	15.0	7.8	4.4	5.8	7.1
EBITDA margin	19.6	10.6	7.7	9.1	10.7
ROA	8.1	3.5	1.9	2.6	3.3
ROE	10.0	4.2	2.2	3.0	3.8
Dividend yield	1.1	1.7	1.4	1.4	1.4
Dividend payout ratio	9.6	21.5	41.5	29.3	22.8
Stability					
Net debt (W bn)	(22)	(17)	(38)	(48)	(52)
Debt/equity ratio (%)	9.6	5.9	1.2	0.0	0.0
Valuation (X)					
PE	9.0	12.4	30.1	21.2	16.5
PB	0.9	0.5	0.6	0.6	0.6
EV/EBITDA	6.4	8.5	14.6	11.5	8.9

Changes to recommendation and price target

Company (Code)	Date	Recommendation	Price target
Sung Kwang Bend (014620)	07-24-14	BUY	W28,000
	11-13-14	BUY	W25,000
	01-14-15	BUY	W16,000
	04-14-15	Hold	-



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BUY	Hold	Underweight (Sell)
79.1%	19.1%	1.8%

Note: % of companies under coverage with this rating

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