

GS E&C (006360)

BUY (Maintain), TP W38,000 (Maintain)

Stock price (May 9, KRW)	29,400
Market cap (USD mn)	1,791
Shares outstanding (mn)	71
52W High/Low (KRW)	33,050/18,950
6M avg. daily turnover (USD mn)	15.0
Free float (%)	68.8
Foreign ownership (%)	13.4
Major shareholders (%)	
Chang-Su Hur and 19 others	29.2

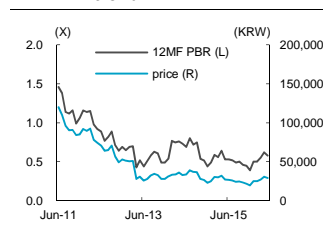
Yr to	Sales	OP	NP	EPS	% chg	EBITDA	PE	EVEBITDA	PB	ROE	DY
Dec	(W bn)	(W bn)	(W bn)	(KRW)	(YoY)	(W bn)	(x)	(x)	(x)	(%)	(%)
2014A	9,488	51	(41)	(667)	NM	128	NM	26.1	0.5	(1.3)	-
2015A	10,573	122	26	363	NM	206	54.4	9.9	0.4	0.8	-
2016F	11,432	201	82	1,177	224.3	245	25.0	14.1	0.6	2.4	-
2017F	11,445	391	234	2,996	154.5	436	9.8	7.1	0.6	6.3	-
2018F	11,536	489	312	3,998	33.5	533	7.4	5.5	0.6	7.8	-

Wait for eight years

Performance

	1M	6M	12M
Absolute (%)	10.7	33.0	(8.3)
Rel. to Kospi (%p)	10.9	35.9	(2.6)

12MF PB trend



First turnaround in five years: For GS Engineering & Construction (GS E&C), 2016 will mark a turnaround year. While there was seemingly no abating of the risk from overseas projects, it is now gradually fading. Once the major problematic projects, such as Power Plant 12 (PP12) and Rabigh 2 (both in Saudi Arabia), are completed in 1H16, it would mark the removal of the biggest risks present at GS E&C for the past five years. While the cost factor remains a concern, the shocks should much alleviate every quarter. The overseas risks are largely reflected in the book as GS E&C has recognized additional costs of more than W1.5tn from the overseas projects. On balance, we forecast OP will grow 65% YoY to W201bn in 2016 and jump 95% YoY to W391bn in 2017. Starting in 2018, GS E&C should be able to regain the annual OP of W500bn-600bn seen during 2005-2007.

Biggest beneficiary of housing profit upcycle: A key driver of the turnaround is the housing profit upcycle that is offsetting the overseas risks. Housing sales recognized by construction companies are typically the largest in the second lagging year. That means after having built more quality housing regardless of the market uncertainties for the past two years, construction companies are set to enjoy profit growth from the housing segment at least through 1H18. GS E&C's housing construction grew 233% YoY to 23,000 units in 2014, which is overwhelming both in volume and growth rate. Since 2014 when the housing market started recovering, GS E&C has enjoyed successful pre-sales for most of its reconstruction projects in Gangnam (a posh district of Seoul) and other notable areas. Unstarted housing PF shrank from W1.3tn to less than W800bn over the past two years. As the PF will be reflected as sales beginning in 2016, the housing COGS ratio may rise by 2-5%p from a record 80% in 1Q16 but it still ensures absolutely solid profitability.

LG Display's OLED capex a clear short/mid-term cash cow: LG Display (LGD) announced a W10tn OLED capex plan at end-2015, which led to GS E&C winning the P10 order (W472.3bn) in February. While it is difficult to estimate how much LGD may spend on construction out of total OLED capex, GS E&C will likely receive orders worth W1.5tn at the least assuming 30% of total capex is allocated to construction and conservatively assuming the orders are equally divided between GS E&C and ServeOne. The core clean room construction will be done by GS E&C while ServeOne may build employee residential units and do the landscaping. GS E&C was re-rated during 2005-2007 driven by LGD's P7 project among others. With short-term, fast-track processing, LGD's project is a positive in terms of cash flow.

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Vietnam projects resumed after eight-year delay; Likely to see outcome since first entry 12 years ago: Following the Ho Chi Minh City market research in 2002, GS E&C took its first step in Vietnam in 2004 by signing a memorandum of understanding (MoU) to pursue the Nha Be new town project with the Ho Chi Minh City People's Committee. Foreigners have been allowed to own residential housing in Vietnam as of July 1, 2015. Since then, the prices for upscale housing in urban areas have risen to surpass the pre-financial crisis level. GS E&C has resumed development works in Vietnam with the Nha Be new town project that was suspended for eight years due to the financial crisis.

In Vietnam, GS E&C has two projects: a build-transfer (BT) work and the Nha Be new town development. Depending on the pre-sale prices, potential revenue from the two projects should range from W5.9tn to W7tn with Nha Be coming in at W4.5tn-5.4tn and the BT at W1.4tn-1.7tn over the next 10 to 12 years. The BT project will sit on ~990,000m² of land transferred in return for GS E&C's construction of the Tan Son Nhat Binh Loi Outer Ring Road (TBO road). The land will be transferred in full in 3Q16 when the TBO road construction is completed. The Nha Be project is 100%-invested by GS E&C. GS E&C has obtained the rights to use ~3.5km² of land, ~10 kilometres south of Ho Chi Minh City, for 70 years. GS E&C is currently filling up the ground where a 300-unit villa apartment will be built with the pre-sales planned in 4Q16. While the revenue contribution would be insignificant in 2016 and 2017, GS E&C should recognize annual sales of W400bn-800bn from the Nha Be project starting in 2018. Accordingly, we revise up 2018F OP by 44%.

Table 11. 2018 earnings revisions

(W bn)

2018F	Previous	Revised	Chg.
Sales	11,229	11,536	2.7%
OP	339	489	44.2%
OPM	3.1%	4.2%	1.1%p
NP	182	312	71.5%

Source: Korea Investment & Securities

Furthermore, GS E&C will start the Thu Thiem new town development after construction is completed for the TBO road. With a land area of ~6.6km², Thu Thiem will be developed into a new urban area matching the size of Phu My Hung, Vietnam's largest new town. Having secured ~39,700m² of land at the site, GS E&C is currently developing a master plan and seeking permissions from the respective authorities.

GS E&C will also develop the Quan 9 (Q9) new town when the Ho Chi Minh City metro system starts running in 2019. While the new town will cover a population of ~19,000, there should be solid demand for residential properties given the supposed ~50,000 jobs created at Samsung Electronics' home appliances plant that will be built near Q9. (The plant will be located in the Saigon High-tech Park, a complex for technology firms, currently being built by Samsung C&T.)

Table 12. GS E&C's real estate development plans in Vietnam

(W bn)

Project	Total sales	Units	Area (3.3 m ²)	Note
Nha Be	4,500	17,000	3,490,000	New urban area development with rights to use the land for 50 years
BT	1,500	5,433	975,342	Earned the right to develop five areas in return for TBO road construction
Riverview	516	258	17,209	High-rise apartment development
Thu Thiem	330	300	40,221	Residential/financial/commercial property development
Q9 new town	654	4,875	917,910	To cover a population of 19,500
Riverside			27,018	Sold
Grand Court			17,940	Sold
Total	6,000	22,433		

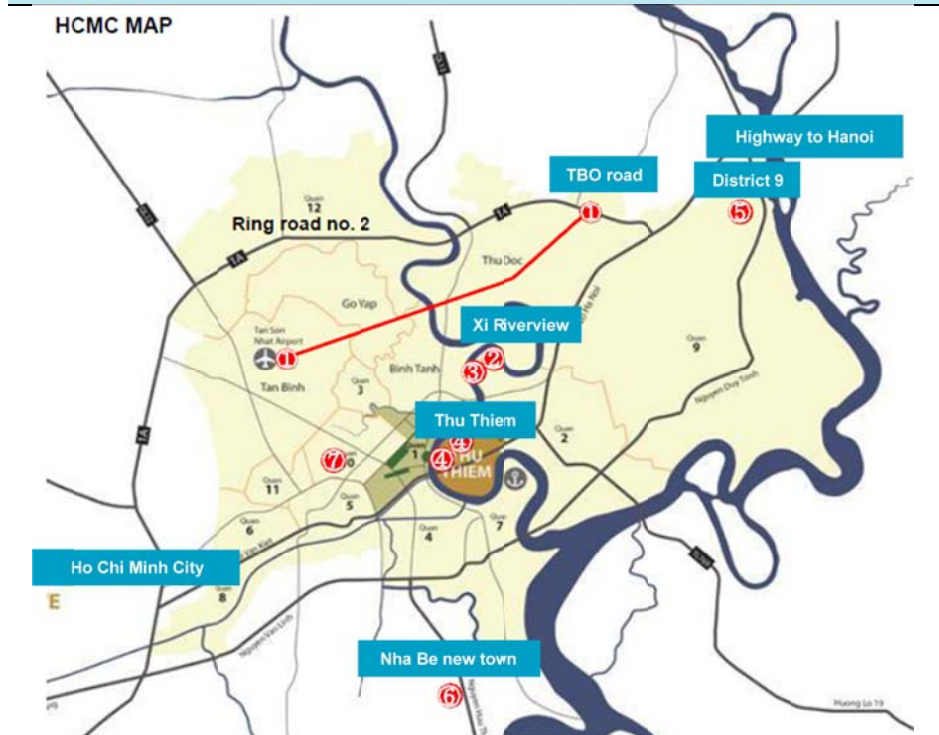
Note: Total sales based on the most conservative pre-sale price estimate of W200mn per unit
Source: Korea Investment & Securities

Table 13. GS E&C project schedule in Vietnam (estimates)

Project	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
TBO road	Construction start					1 st -phase running			Completion								
Riverview		Pre-sale			Completion												
BT																	
Thu Thiem																	
Q9 new town																	
Nha Be																	

Source: Korea Investment & Securities

Figure 40. Overview of GS E&C's Vietnam development plans



Source: Company data, Korea Investment & Securities

Table 14. Profit scenario analysis for GS E&C's Vietnam BT project (W bn)

Pre-sale price per unit	(1) 0.20	(2) 0.22	(3) 0.25	Assumption
Housing pre-sale revenue	1,087	1,195	1,358	W200mn-250mn per household
Commercial property revenue	305	305	305	
Total revenue	1,391	1,500	1,663	
Construction cost	845	845	845	USD2,300/3.3m ²
Land acquisition cost	315	315	315	BT road construction cost
SG&A cost	70	75	83	5% of revenue
Project profit	162	266	421	
Project profitability	14.9%	22.2%	31.0%	

Source: Korea Investment & Securities

Table 15. Profit scenario analysis for GS E&C's Vietnam Nha Be project (W bn)

Pre-sale price per unit	(1) 0.20	(2) 0.22	(3) 0.25	Assumption
Housing pre-sale revenue	3,400	3,740	4,250	W200mn-250mn per household
Commercial property revenue	1,100	1,100	1,100	
Total revenue	4,500	4,840	5,350	
Construction cost	2,335	2,335	2,335	USD2,300/3.3m ²
Land acquisition cost	192	192	192	Land cost USD500/m ²
SG&A cost	225	242	268	5% of revenue
Project profit	648	971	1,456	
Project profitability	19.1%	26.0%	34.3%	

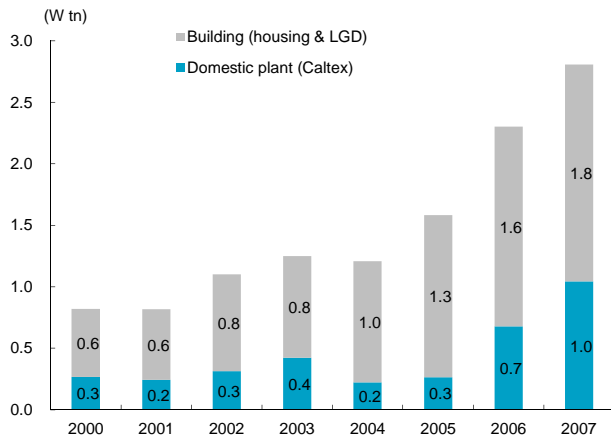
Source: Korea Investment & Securities

Ready to dream again in Vietnam: Vietnam is currently in a housing shortage as more people favor living in apartments driven by economic growth, rapid urbanization and the rise of the middle-income class. For Vietnam to achieve smooth growth, new towns must be built. Vietnam is facing a similar situation as Korea in 1989 when new towns such as Bundang were built in the first phase of new town development with the economy achieving fast growth and Seoul becoming overcrowded. GS E&C is currently promoting Vietnam's Nha Be new town project that features a similar objective as Bundang (self-sufficient city) and an advantage such as easy access to the heart of Ho Chi Minh City. What is important is GS E&C can now dream again about development projects in Vietnam that became stranded due to the 2008 global financial crisis and the clearing of bad projects at home and abroad.

Full revival of past premium factors: During the pre-financial crisis period from 2005-2007, GS E&C was the builder that received the biggest premium. GS E&C's explosive growth and valuation premium were driven by 1) benefits from GS Caltex's investment in the no. 3 refinery upgrade and LGD's investment in P7, 2) better profitability at the housing business in line with the launch of the "Xi" apartment brand and 3) greater plant orders from abroad including Oman and an overseas OPM reaching 8-9%. There were also high hopes for the development projects in Vietnam.

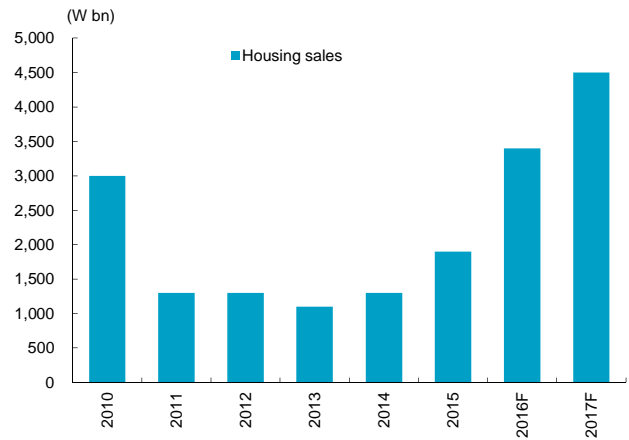
GS E&C that seemed incapable of making a comeback was able to strengthen its fundamentals thanks to a thorough cleanup of financials and the recognition of bad projects since 2013. At present, GS E&C is witnessing a repeat of 1) LGD's OLED investment although it is unlikely to be as big as past affiliate projects, 2) greater global refinery investment driven by a wider refining margin and 3) a rising market share for the renewal business in core regions. With the resumption of Vietnam's development projects that failed to gain traction in the past, we focus on the mounting possibility of recouping investment and achieving long-term growth.

Figure 41. GS E&C valuation uptick in 2000s driven by LGD, housing and refinery



Source: Company data, Korea Investment & Securities

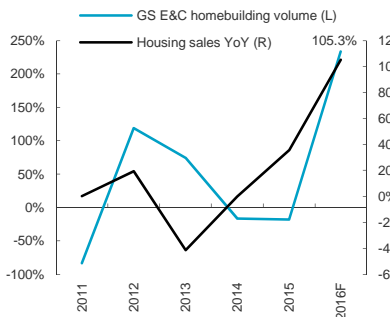
Figure 42. Housing sales



Source: Company data, Korea Investment & Securities

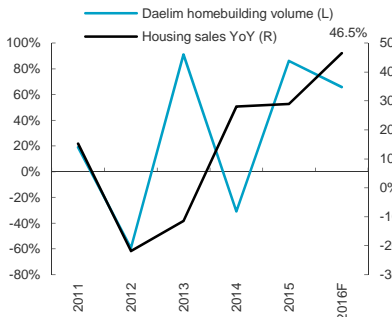
We analyzed the 2016 housing sales growth driven by construction volume for each major builder. As shown below, GS E&C has enjoyed a big housing construction volume since 2014 compared to Daewoo E&C or Hyundai Development that are viewed as typical homebuilders. Accordingly, GS E&C's housing division should be able to deliver definite profit growth in 2016.

Figure 43. GS E&C homebuilding volume vs. housing sales YoY chg.



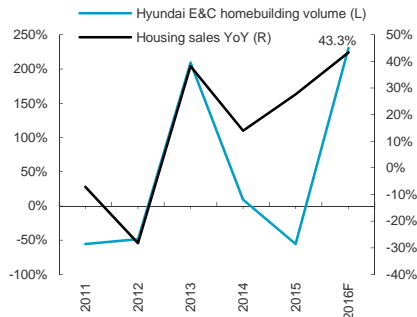
Source: Company data, Korea Investment & Securities

Figure 44. Daelim Ind. homebuilding volume vs. housing sales YoY chg.



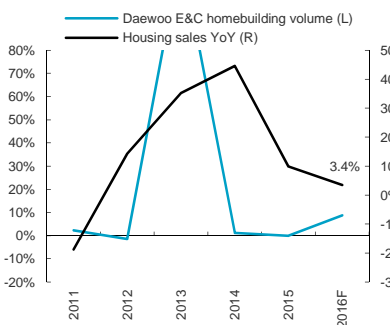
Source: Company data, Korea Investment & Securities

Figure 45. Hyundai E&C homebuilding volume vs. housing sales YoY chg.



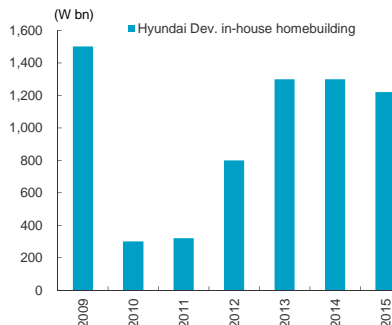
Source: Company data, Korea Investment & Securities

Figure 46. Daewoo E&C homebuilding volume vs. housing sales YoY chg.



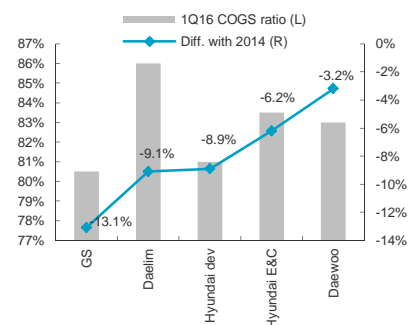
Source: Company data, Korea Investment & Securities

Figure 47. Hyundai Development homebuilding volume from in-house business (sales basis)



Source: Company data, Korea Investment & Securities

Figure 48. Housing COGS by company



Source: Company data, Korea Investment & Securities

Table 16. Earnings estimates

(W bn)

	1Q15	2Q15	3Q15	4Q15	1Q16	2Q16F	3Q16F	4Q16F	2015	2016F	2017F	2018F
Sales	2,316	2,491	2,789	2,977	2,639	2,647	2,785	3,360	10,573	11,432	11,445	11,536
YoY	13.5	5.3	21.0	7.2	13.9	6.3	(0.1)	12.9	11.4	8.1	0.1	0.8
Civil engineering	307	304	310	345	337	330	322	268	1,266	1,257	1,373	1,641
Plant	1,149	1,223	1,234	1,301	1,170	1,090	1,236	1,482	4,907	4,978	4,567	4,414
Power	185	169	240	316	178	206	228	381	911	993	893	823
Building/Housing	615	731	967	998	939	971	949	1,145	3,311	4,004	4,412	4,458
(Domestic)	845	1,023	1,288	1,415	1,217	1,522	1,586	1,672	4,571	5,996	6,153	5,630
(Overseas)	1,471	1,468	1,501	1,562	1,422	1,126	1,200	1,688	6,002	5,436	5,291	5,906
COGS-to-sales (%)	94.6	94.5	95.9	94.2	95.2	94.5	94.3	94.4	94.8	94.6	92.8	91.6
Civil engineering	96.9	96.0	93.5	95.3	96.4	96.0	95.0	92.0	95.4	95.0	94.0	95.0
Plant	94.8	93.3	106.9	99.1	104.7	98.0	97.0	96.9	98.6	99.0	96.0	93.0
Power	102.2	118.6	98.9	105.5	90.9	100.0	105.0	98.6	105.5	99.0	99.0	97.0
Building/Housing	90.7	90.2	81.6	83.3	83.5	89.0	88.0	90.8	85.7	88.0	88.0	88.0
(Domestic)	95.0	92.4	85.0	90.3	86.2	89.0	89.0	91.1	90.2	89.0	90.5	90.5
(Overseas)	94.4	96.0	105.4	97.7	102.9	97.8	97.4	103.1	98.4	100.7	95.5	92.7
SG&A	105	99	102	120	99	100	105	116	426	420	430	480
SG&A-to-sales %	4.5	4.0	3.7	4.0	3.8	3.8	3.8	3.5	4.0	3.7	3.8	4.2
OP	20	38	11	53	29	46	55	71	122	201	391	489
OPM	0.9	1.5	0.4	1.8	1.1	1.7	2.0	2.1	1.2	1.8	3.4	4.2
EBT	22	2	20	(13)	13	26	35	34	31	108	308	412
NP	1	5	53	(30)	12	20	26	24	29	82	234	312
NPM	0.1	0.2	1.9	(1.0)	0.5	0.7	0.9	0.7	0.3	0.7	2.0	2.7

Source: Korea Investment & Securities

Construction/Construction materials

Balance sheet

FY-ending Dec. (W bn)	2014A	2015A	2016F	2017F	2018F
Current assets	8,653	9,549	10,450	10,100	9,604
Cash & cash equivalents	2,151	2,429	1,715	1,717	1,730
Accounts & other receivables	4,314	4,486	6,351	5,722	5,191
Inventory	613	796	586	861	868
Non-current assets	4,442	3,456	3,030	3,035	3,050
Investment assets	887	867	722	723	729
Tangible assets	2,456	1,339	1,642	1,645	1,649
Intangible assets	170	145	68	68	68
Total assets	13,095	13,005	13,481	13,136	12,654
Current liabilities	6,127	7,139	7,376	6,846	6,093
Accounts & other payables	2,903	3,875	2,858	2,289	2,192
ST debt & bonds	1,026	948	1,298	1,268	1,238
Current portion of LT debt	484	976	1,006	956	906
Non-current liabilities	3,386	2,518	2,425	2,376	2,335
Debentures	932	290	0	0	0
LT debt & financial liabilities	1,555	1,330	1,330	1,280	1,230
Total liabilities	9,513	9,657	9,801	9,222	8,428
Controlling interest	3,271	3,284	3,616	3,850	4,162
Capital stock	355	355	397	397	397
Capital surplus	611	611	818	818	818
Other reserves	(141)	(87)	(87)	(87)	(87)
Retained earnings	2,534	2,537	2,619	2,853	3,165
Minority interest	311	64	64	64	64
Shareholders' equity	3,582	3,348	3,680	3,914	4,226

Cash flow

FY-ending Dec. (W bn)	2014A	2015A	2016F	2017F	2018F
C/F from operations	572	(8)	(955)	199	221
Net profit	(22)	29	82	234	312
Depreciation	62	69	43	43	43
Amortization	15	14	1	1	1
Net incr. in W/C	449	(137)	(1,136)	(73)	(133)
Others	68	17	55	(6)	(2)
C/F from investing	(334)	508	(74)	(42)	(52)
Capex	(308)	(227)	(347)	(47)	(47)
Decr. in fixed assets	72	2	0	0	0
Incr. in investment	(58)	763	152	6	1
Net incr. in intangible assets	(1)	(0)	76	(1)	(1)
Others	(39)	(30)	45	0	(5)
C/F from financing	35	(228)	315	(155)	(155)
Incr. in equity	549	4	250	0	0
Incr. in debt	0	0	65	(155)	(155)
Dividends	(2)	(1)	0	0	0
Others	(512)	(231)	0	0	0
C/F from others	13	6	0	0	0
Increase in cash	286	277	(714)	2	14

Note: K-IFRS (consolidated)

Income statement

FY-ending Dec. (W bn)	2014A	2015A	2016F	2017F	2018F
Sales	9,488	10,573	11,432	11,445	11,536
COGS	9,059	10,025	10,811	10,623	10,567
Gross profit	429	548	621	821	969
SG&A expenses	378	426	420	430	480
Operating profit	51	122	201	391	489
Financial income	265	432	50	40	39
Interest income	60	43	50	40	39
Financial expenses	337	415	130	130	123
Interest expenses	116	119	130	130	123
Other non-operating profit	(15)	(111)	(20)	0	0
Gains (Losses) in associates, subsidiaries and JV	6	3	7	7	7
Earnings before tax	(30)	31	108	308	412
Income taxes	(7)	2	26	75	100
Net profit	(22)	29	82	234	312
Net profit of controlling interest	(41)	26	82	234	312
Other comprehensive profit	(106)	(74)	0	0	0
Total comprehensive profit	(128)	(44)	82	234	312
Total comprehensive profit of controlling interest	(145)	(38)	82	234	312
EBITDA	128	206	245	436	533

Key financial data

FY-ending Dec.	2014A	2015A	2016F	2017F	2018F
Per-share data (KRW)					
EPS	(667)	363	1,177	2,996	3,998
BPS	47,136	47,324	46,449	49,391	53,317
DPS	0	0	0	0	0
Growth (%)					
Sales growth	(0.8)	11.4	8.1	0.1	0.8
OP growth	NM	138.6	64.7	94.7	24.8
NP growth	NM	NM	214.1	185.5	33.5
EPS growth	NM	NM	224.3	154.5	33.5
EBITDA growth	NM	60.4	19.3	77.6	22.3
Profitability (%)					
OP margin	0.5	1.2	1.8	3.4	4.2
NP margin	(0.4)	0.2	0.7	2.0	2.7
EBITDA margin	1.4	1.9	2.1	3.8	4.6
ROA	(0.2)	0.2	0.6	1.8	2.4
ROE	(1.3)	0.8	2.4	6.3	7.8
Dividend yield	-	-	-	-	-
Dividend payout ratio	NM	0.0	0.0	0.0	0.0
Stability					
Net debt (W bn)	1,454	645	1,370	1,019	870
Debt/equity ratio (%)	117.2	110.7	102.5	87.4	77.9
Valuation (x)					
PE	NM	54.4	25.0	9.8	7.4
PB	0.5	0.4	0.6	0.6	0.6
EV/EBITDA	26.1	9.9	14.1	7.1	5.5

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