true friend Korea Investment & Securities Co., Ltd.

Company Note
December 20, 2013

# SEMCO (009150)

12M rating **Hold (Downgrade)**

## 4Q13 preview: Wait until Galaxy S5 next spring

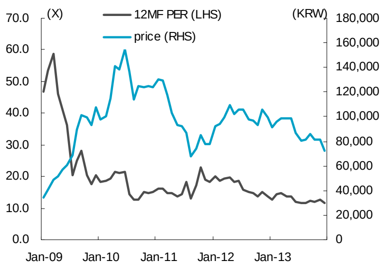
**Stock Data**

| | |
|---|---|
| KOSPI (Dec 19, pt) | 1,976 |
| Stock price (Dec 19, KRW) | 72,000 |
| Market cap (USD mn) | 5,073 |
| Shares outstanding (mn) | 75 |
| 52-Week high/low (KRW) | 106,000/72,000 |
| 6M avg. daily turnover (USD mn) | 33.6 |
| Free float / Foreign ownership (%) | 76.3/17.9 |
| Major shareholders (%) | |
| Samsung Electronics Co.,Ltd and 5 others | 23.7 |
| National Pension Service (NPS) | 6.2 |

**Performance**

| | 1M | 6M | 12M |
|---|---|---|---|
| Absolute (%) | (6.7) | (20.7) | (31.1) |
| Relative to KOSPI (%p) | (4.0) | (25.3) | (30.2) |

**12MF PE trend**




Source: WISEfn consensus

### Downgrade to Hold

We downgrade SEMCO to Hold as we revised down 4Q13 and 2014 earnings marginally. 1) Handset-related component orders should be weaker than previously expected on Samsung Electronics' aggressive component inventory adjustment. 2) Handset-related component sales mix is eroding as Samsung Electronics' weighting of low- and mid-range smartphones rises. 3) The competitive position against Japanese players deteriorated on a strong KRW and weak JPY. 4) Competition for smartphone FC-CSP intensified and FC-BGA share at a major client declined.

### Cut 4Q13 OP to W55.2bn on seasonal factors

We estimate 4Q13 sales at W1.77tn, -16% QoQ, and OP at W55.2bn. We believe OP will fall sharply due to Samsung Electronics' aggressive inventory adjustment and the eroding sales mix. Specifically, 1) the weighting of high-margin 13MP camera modules should fall sharply, 2) BGA shipments should disappoint on growing smartphone competition, and 3) power sales should be poor as TV demand remains soft.

### 2014 OP to grow 10% YoY on new products

However, we believe that new products will lift OP in 2014. 1) The inductor business has picked up on thin film type inductors, for which SEMCO has a competitive advantage. 2) High-margin solution type MLCC weighting should expand. 3) Large touch panels equipped with mesh products should be supplied from 1Q14. 4) Samsung Electronics Galaxy Gear 2 equipment should be equipped with more SEMCO components. As such, we forecast 2014 OP at W610bn, +10% YoY.

### Shares to rally on Galaxy S5 component supply

We project Samsung Electronics will release the Galaxy S5 around end-April 2014. As such, component supplies should begin in March. As a major component vendor, SEMCO should benefit from the release of the next flagship smartphone. Accordingly, shares should rally as Galaxy S5-related component supply begins. In addition, SEMCO has been negotiating with local smartphone makers in China. If sales visibility firms, we believe the share rally will accelerate.

| Yr to Dec | Sales (W bn) | OP (W bn) | EBT (W bn) | NP (W bn) | EPS (won) | % chg (YoY) | EBITDA (W bn) | PE (x) | EV/EBITDA (x) | PB (x) | ROE (%) |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 2011A | 6,032 | 278 | 364 | 349 | 4,510 | (37.1) | 941 | 17.2 | 7.7 | 1.7 | 10.0 |
| 2012A | 7,913 | 580 | 583 | 441 | 5,685 | 26.1 | 1,099 | 17.4 | 7.6 | 2.0 | 11.9 |
| 2013F | 8,316 | 555 | 509 | 367 | 4,731 | (16.8) | 1,238 | 15.2 | 5.1 | 1.3 | 9.1 |
| 2014F | 9,263 | 608 | 563 | 399 | 5,147 | 8.8 | 1,335 | 14.0 | 4.7 | 1.2 | 9.2 |
| 2015F | 10,108 | 668 | 624 | 443 | 5,705 | 10.8 | 1,412 | 12.6 | 4.3 | 1.1 | 9.4 |

Note: Net profit and EPS are based on figures attributed to controlling interest

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Table 1. Quarterly earnings by division (revised)

(W bn, %)

| | 1Q12 | 2Q12 | 3Q12 | 4Q12 | 1Q13 | 2Q13 | 3Q13 | 4Q13F | 2011 | 2012 | 2013F | 2014F |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Sales** | **1,748** | **1,908** | **2,183** | **2,074** | **2,044** | **2,385** | **2,118** | **1,769** | **6,988** | **7,913** | **8,316** | **9,263** |
| ACI | 501 | 555 | 530 | 516 | 459 | 483 | 483 | 414 | 1,601 | 2,002 | 1,837 | 2,076 |
| LCR | 441 | 473 | 512 | 472 | 478 | 500 | 499 | 454 | 1,691 | 1,806 | 1,929 | 2,097 |
| OMS | 424 | 486 | 663 | 600 | 591 | 923 | 682 | 488 | 2,057 | 2,068 | 2,685 | 3,211 |
| CDS | 383 | 394 | 478 | 486 | 431 | 457 | 424 | 413 | 1,640 | 1,669 | 1,726 | 1,878 |
| **OP** | **107** | **156** | **200** | **145** | **113** | **222** | **164** | **55** | **330** | **608** | **555** | **608** |
| ACI | 59 | 78 | 78 | 67 | 37 | 62 | 54 | 22 | 104 | 282 | 175 | 218 |
| LCR | 26 | 42 | 49 | 37 | 39 | 56 | 46 | 20 | 179 | 154 | 162 | 182 |
| OMS | 14 | 24 | 46 | 29 | 24 | 87 | 52 | 9 | 11 | 113 | 172 | 163 |
| CDS | 7 | 12 | 27 | 12 | 13 | 18 | 12 | 4 | 36 | 59 | 46 | 45 |
| **OP margin (%)** | **6.1** | **8.2** | **9.2** | **7.0** | **5.5** | **9.3** | **7.8** | **3.1** | **4.7** | **7.7** | **6.7** | **6.6** |
| ACI | 11.8 | 14.1 | 14.8 | 12.9 | 8.0 | 12.8 | 11.2 | 5.4 | 6.5 | 14.1 | 9.5 | 10.5 |
| LCR | 5.8 | 8.9 | 9.6 | 7.9 | 8.2 | 11.2 | 9.3 | 4.4 | 10.6 | 8.5 | 8.4 | 8.7 |
| OMS | 3.4 | 4.9 | 6.9 | 4.8 | 4.1 | 9.4 | 7.6 | 1.8 | 0.5 | 5.5 | 6.4 | 5.1 |
| CDS | 2.0 | 3.0 | 5.6 | 2.6 | 2.9 | 3.9 | 2.8 | 1.0 | 2.2 | 3.5 | 2.7 | 2.4 |

Source: SEMCO, Korea Investment & Securities

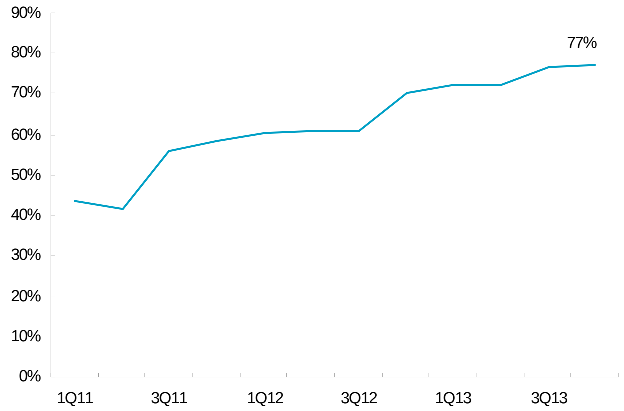
Table 2. Quarterly earnings by division (previous)

(W bn %)

| | 1Q12 | 2Q12 | 3Q12 | 4Q12 | 1Q13 | 2Q13 | 3Q13 | 4Q13F | 2011 | 2012 | 2013F | 2014F |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Sales** | **1,748** | **1,908** | **2,183** | **2,074** | **2,044** | **2,385** | **2,118** | **2,143** | **6,988** | **7,913** | **8,732** | **9,975** |
| ACI | 501 | 555 | 530 | 516 | 479 | 483 | 483 | 506 | 1,601 | 2,002 | 1,948 | 2,220 |
| LCR | 441 | 473 | 512 | 472 | 498 | 500 | 499 | 481 | 1,691 | 1,806 | 1,979 | 2,167 |
| OMS | 424 | 486 | 663 | 600 | 617 | 923 | 682 | 739 | 2,057 | 2,068 | 2,973 | 3,697 |
| CDS | 383 | 394 | 478 | 486 | 450 | 457 | 424 | 417 | 1,640 | 1,669 | 1,725 | 1,890 |
| **OP** | **107** | **156** | **200** | **145** | **113** | **222** | **164** | **153** | **330** | **608** | **654** | **723** |
| ACI | 59 | 78 | 78 | 67 | 37 | 62 | 54 | 62 | 104 | 282 | 224 | 265 |
| LCR | 26 | 42 | 49 | 37 | 39 | 56 | 46 | 50 | 179 | 154 | 204 | 216 |
| OMS | 14 | 24 | 46 | 29 | 24 | 87 | 52 | 33 | 11 | 113 | 179 | 190 |
| CDS | 7 | 12 | 27 | 12 | 13 | 18 | 12 | 8 | 36 | 59 | 46 | 51 |
| **OP margin (%)** | **6.1** | **8.2** | **9.2** | **7.0** | **5.5** | **9.3** | **7.8** | **7.1** | **4.7** | **7.7** | **7.5** | **7.2** |
| ACI | 11.8 | 14.1 | 14.8 | 12.9 | 7.7 | 12.8 | 11.2 | 12.4 | 6.5 | 14.1 | 11.5 | 11.9 |
| LCR | 5.8 | 8.9 | 9.6 | 7.9 | 7.9 | 11.2 | 9.3 | 10.3 | 10.6 | 8.5 | 10.3 | 10.0 |
| OMS | 3.4 | 4.9 | 6.9 | 4.8 | 4.0 | 9.4 | 7.6 | 4.5 | 0.5 | 5.5 | 6.0 | 5.1 |
| CDS | 2.0 | 3.0 | 5.6 | 2.6 | 2.8 | 3.9 | 2.8 | 1.8 | 2.2 | 3.5 | 2.7 | 2.7 |

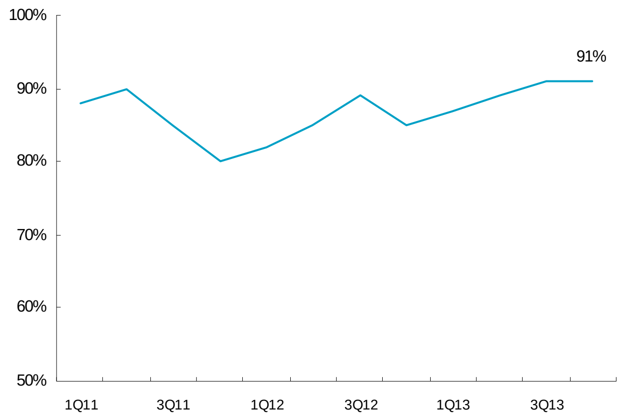
Source: SEMCO, Korea Investment & Securities

Figure 1. FC-CSP weight in BGA sales



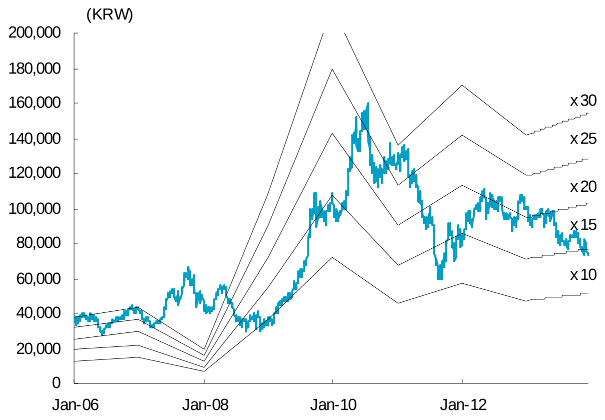

Source: SEMCO, Korea Investment & Securities:

Figure 2. MLCC utilization



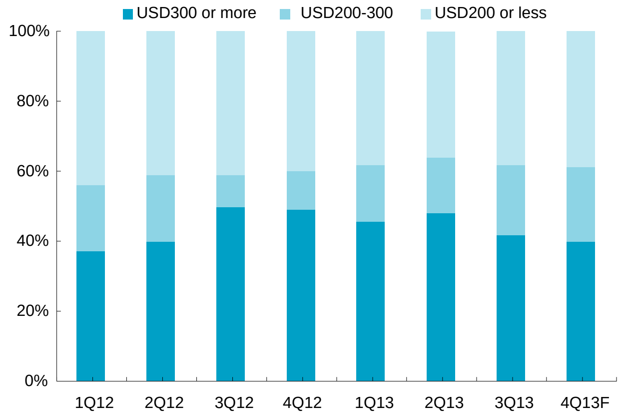

Source: SEMCO, Korea Investment & Securities:

**Figure 3. SEMCO PE trend**




Source: Datastream, Korea Investment & Securities:

**Figure 4. SEC smartphone portion trend by price**




Source: Samsung Electronics, Korea Investment & Securities:

## Company overview & Glossary

SAMSUNG ELECTRO-MECHANICS CO.,LTD. is a Korea-based company engaged in the manufacture of electronic components. The company operates in four business segments: advanced circuit interconnection (ACI), low value chip resistor (LCR), orbit motor series (OMS) and CDS segment. Its ACI segment provides high-density interconnection (HDI) substrates, ball grid array (BGA) substrates and flexible circuit boards (FCBs). Its LCR segment provides multilayer ceramic capacitors (MLCCs), chip resistors, chip inductors and tantal capacitors. Its OMS segment provides camera modules and precision motors. Its CDS segment provides power modules, tuner modules and network modules. On March 30, 2012, the company acquired a 100% stake in a Japan-based company, engaged in the manufacture of hard disk drive (HDD) motors.

- HDI : High density interconnector
- RF-PCB : Radio frequency printed circuit board
- FC-CSP : Flip chip chip scale package
- MLCC : Multilayer ceramic capacitor

### Balance sheet

| FY-ending Dec. (W bn) | 2011A | 2012A | 2013F | 2014F | 2015F |
|---|---|---|---|---|---|
| Current assets | 3,697 | 2,631 | 2,711 | 2,853 | 2,952 |
| Cash & cash equivalent | 526 | 684 | 699 | 648 | 708 |
| Accounts & other receivables | 882 | 1,026 | 1,081 | 1,112 | 1,112 |
| Inventory | 760 | 838 | 832 | 982 | 1,011 |
| Non-current assets | 3,632 | 4,260 | 4,744 | 4,932 | 5,240 |
| Investment assets | 1,274 | 1,407 | 1,479 | 1,477 | 1,611 |
| Tangible assets | 2,278 | 2,586 | 2,985 | 3,143 | 3,288 |
| Intangible assets | 56 | 245 | 258 | 287 | 314 |
| Total assets | 7,329 | 6,891 | 7,455 | 7,785 | 8,192 |
| Current liabilities | 2,711 | 1,959 | 2,363 | 2,474 | 2,622 |
| Accounts & other payables | 763 | 925 | 972 | 1,083 | 1,182 |
| ST debt & bond | 796 | 801 | 901 | 951 | 1,001 |
| Current portion of LT debt | 300 | 140 | 190 | 140 | 140 |
| Non-current liabilities | 742 | 967 | 827 | 715 | 597 |
| Debentures | 0 | 0 | 0 | 0 | 0 |
| LT debt & financial liabilities | 495 | 579 | 420 | 262 | 103 |
| Total liabilities | 3,453 | 2,926 | 3,191 | 3,189 | 3,219 |
| Controlling interest | 3,507 | 3,894 | 4,184 | 4,506 | 4,871 |
| Capital stock | 388 | 388 | 388 | 388 | 388 |
| Capital surplus | 1,046 | 1,045 | 1,045 | 1,045 | 1,045 |
| Capital adjustments | (6) | (2) | (2) | (2) | (2) |
| Retained earnings | 1,529 | 1,865 | 2,154 | 2,476 | 2,841 |
| Minority interest | 368 | 71 | 81 | 91 | 102 |
| Shareholders' equity | 3,876 | 3,966 | 4,264 | 4,596 | 4,973 |

### Income statement

| FY-ending Dec. (W bn) | 2011A | 2012A | 2013F | 2014F | 2015F |
|---|---|---|---|---|---|
| Sales | 6,032 | 7,913 | 8,316 | 9,263 | 10,108 |
| COGS | 5,050 | 6,524 | 6,911 | 7,709 | 8,407 |
| Gross profit | 981 | 1,389 | 1,405 | 1,554 | 1,701 |
| SG&A expense | 704 | 808 | 850 | 946 | 1,033 |
| Operating profit | 278 | 580 | 555 | 608 | 668 |
| Financial income | 94 | 31 | 33 | 32 | 30 |
| Interest income | 11 | 17 | 19 | 19 | 16 |
| Financial expense | 47 | 55 | 62 | 59 | 54 |
| Interest expense | 46 | 49 | 56 | 53 | 48 |
| Other non-operating profit | 39 | 27 | (17) | (19) | (20) |
| Gains (Losses) in associates, subsidiaries and JV | 0 | 0 | 0 | 0 | 0 |
| Earnings before tax | 364 | 583 | 509 | 563 | 624 |
| Income taxes | 56 | 158 | 132 | 153 | 170 |
| Net profit | 392 | 452 | 376 | 410 | 454 |
| Net profit of controlling interest | 349 | 441 | 367 | 399 | 443 |
| Other comprehensive profit | (237) | (3) | 0 | 0 | 0 |
| Total comprehensive profit | 155 | 449 | 376 | 410 | 454 |
| Total comprehensive profit of controlling interest | 108 | 442 | 367 | 399 | 443 |
| EBITDA | 941 | 1,099 | 1,238 | 1,335 | 1,412 |

### Cash flow

| FY-ending Dec. (W bn) | 2011A | 2012A | 2013F | 2014F | 2015F |
|---|---|---|---|---|---|
| C/F from operating | 489 | 1,119 | 1,279 | 1,105 | 1,301 |
| Net profit | 392 | 452 | 376 | 410 | 454 |
| Depreciation | 648 | 500 | 651 | 692 | 705 |
| Amortization | 15 | 19 | 32 | 35 | 39 |
| Net incr. in W/C | (675) | 7 | 210 | (54) | 83 |
| Others | 109 | 141 | 10 | 22 | 20 |
| C/F from investing | (976) | (702) | (1,177) | (918) | (1,055) |
| CAPEX | (1,240) | (907) | (1,100) | (900) | (900) |
| Decr. in fixed assets | 170 | 50 | 50 | 50 | 50 |
| Incr. in investment | 99 | 154 | (72) | 3 | (135) |
| Net incr. in intangible assets | (6) | (9) | (44) | (65) | (65) |
| Others | 1 | 10 | (11) | (6) | (5) |
| C/F from financing | 301 | (294) | (87) | (237) | (187) |
| Incr. in equity | 7 | 5 | 0 | 0 | 0 |
| Incr. in debts | 458 | (177) | (9) | (159) | (109) |
| Dividends | (88) | (58) | (78) | (78) | (78) |
| Others | (76) | (64) | 0 | 0 | 0 |
| C/F from others | 16 | 33 | 0 | 0 | 0 |
| Increase in cash | (169) | 158 | 15 | (50) | 59 |

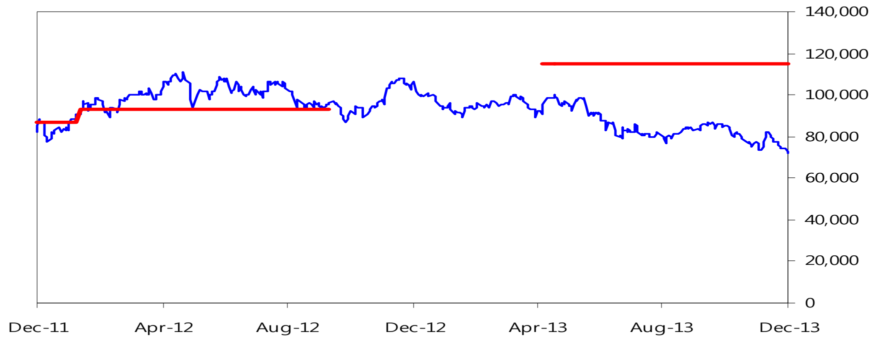
Note: Based on K-IFRS (consolidated)

### Key financial data

| FY-ending Dec. | 2011A | 2012A | 2013F | 2014F | 2015F |
|---|---|---|---|---|---|
| per share data (KRW) | | | | | |
| EPS | 4,510 | 5,685 | 4,731 | 5,147 | 5,705 |
| BPS | 45,295 | 50,214 | 53,944 | 58,090 | 62,794 |
| DPS | 750 | 1,000 | 1,000 | 1,000 | 1,000 |
| Growth (%) | | | | | |
| Sales growth | 6.7 | 31.2 | 5.1 | 11.4 | 9.1 |
| OP growth | (40.3) | 108.9 | (4.4) | 9.5 | 9.9 |
| NP growth | (37.0) | 26.1 | (16.7) | 8.8 | 10.8 |
| EPS growth | (37.1) | 26.1 | (16.8) | 8.8 | 10.8 |
| EBITDA growth | (4.4) | 16.8 | 12.6 | 7.8 | 5.8 |
| Profitability (%) | | | | | |
| OP margin | 4.6 | 7.3 | 6.7 | 6.6 | 6.6 |
| NP margin | 5.8 | 5.6 | 4.4 | 4.3 | 4.4 |
| EBITDA margin | 15.6 | 13.9 | 14.9 | 14.4 | 14.0 |
| ROA | 5.5 | 6.4 | 5.2 | 5.4 | 5.7 |
| ROE | 10.0 | 11.9 | 9.1 | 9.2 | 9.4 |
| Dividend yield | 1.0 | 1.0 | 1.4 | 1.4 | 1.4 |
| Stability | | | | | |
| Net debt (W bn) | 1,037 | 807 | 772 | 658 | 486 |
| Debt/equity ratio (%) | 41.0 | 38.4 | 35.5 | 29.4 | 25.0 |
| Valuation (X) | | | | | |
| PE | 17.2 | 17.4 | 15.2 | 14.0 | 12.6 |
| PB | 1.7 | 2.0 | 1.3 | 1.2 | 1.1 |
| PS | 1.0 | 1.0 | 0.7 | 0.6 | 0.6 |
| EV/EBITDA | 7.7 | 7.6 | 5.1 | 4.7 | 4.3 |

Changes to recommendation and price target

| Company (Code) | Date | Recommendation | Price target |
|---|---|---|---|
| Samsung Electro-Mechanics (009150) | 01-30-12 | Hold | W93,000 |
| | 09-28-12 | Hold | - |
| | 04-25-13 | BUY | W115,000 |
| | 12-19-13 | Hold | - |




■ **Guide to Korea Investment & Securities Co., Ltd. stock ratings based on absolute 12-month forward share price performance**
- BUY: Expected to give a return of +15% or more
- Hold: Expected to give a return between -15% and 15%
- Underweight: Expected to give a return of -15% or less
- Korea Investment & Securities does not offer target prices for stocks with Hold or Underweight ratings.

■ **Guide to Korea Investment & Securities Co., Ltd. sector ratings for the next 12 months**
- Overweight: Recommend increasing the sector's weighting in the portfolio compared to its respective weighting in the Kospi (Kosdaq) based on market capitalization.
- Neutral: Recommend maintaining the sector's weighting in the portfolio in line with its respective weighting in the Kospi (Kosdaq) based on market capitalization.
- Underweight: Recommend reducing the sector's weighting in the portfolio compared to its respective weighting in the Kospi (Kosdaq) based on market capitalization.

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I/We, as the research analyst/analysts who prepared this report, do hereby certify that the views expressed in this research report accurately reflect my/our personal views about the subject securities and issuers discussed in this report. I/We do hereby also certify that no part of my/our compensation was, is, or will be directly or indirectly related to the specific recommendations or views contained in this research report.

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Korea Investment & Securities Co., Ltd., or its affiliates was not making a market in Samsung Electro-Mechanics's securities at the time that the research report was published.

Korea Investment & Securities Co., Ltd. does not own over 1% of Samsung Electro-Mechanics shares as of December 19, 2013.
Korea Investment & Securities Co., Ltd. has not provided this report to various third parties.
Neither the analysts covering these companies nor their associates own any shares of as of December 19, 2013.
Korea Investment & Securities Co., Ltd. has issued ELW with underlying stocks of Samsung Electro-Mechanics and is the liquidity provider.

Prepared by: Kevin Lee