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Company Update



Jongwook Lee

Analyst

jwstar.lee@samsung.com

822 2020 7793

AT A GLANCE

SELL

HOLD

BUY

Target price KRW200,000 (27.7%)

Current price KRW156,600

Market cap	KRW1.7T/USD1.5b
Shares (float)	10,547,673 (40.8%)
52-week high/low	KRW193,800/KRW135,600
Avg daily trading value (60-day)	KRW6.0b/USD5.3m

ONE-YEAR PERFORMANCE

	1M	6M	12M
SK Materials (%)	3.7	-12.5	-8.7
Vs Kosdaq (%pts)	-2.0	-5.8	17.6

KEY CHANGES

(KRW)	New	Old	Diff
Recommend.	BUY	BUY	
Target price	200,000	230,000	-13.0%
2018E EPS	11,507	12,335	-6.7%
2019E EPS	13,882	14,602	-4.9%

SAMSUNG vs THE STREET

No of estimates	9
Target price	217,400
Recommendation	4.1

BUY★★★: 5 / BUY: 4 / HOLD: 3 / SELL: 2 / SELL★★★: 1

SK Materials (036490)

Be patient and focus on long-term growth

- We recommend a strategy of accumulating SK Materials shares while they are undervalued and taking profit when sales of new products grow.
- The firm's 1Q19 operating profit should prove its low earnings volatility.
- We cut our 12-month target price to KRW200,000, a 15% discount to a level implied by a historical P/B vs ROE regression analysis.

WHAT'S THE STORY?

Investment strategy: Industry conditions and investor sentiment tell us that SK Materials may not be a top priority for share accumulation in this sector. But the company is no longer a commodity play, whose performance relies on NF₃ price movements. Based on years-long product portfolio expansion for captive clients, SK Materials enjoys a steady ROE and is steadily hiking dividends. We recommend investors accumulate shares when they are deeply undervalued to their historical average and take profit when new products take off. We expect the next new-product cycle to kick off in 3Q19 when the firm's new phosphoric acid etchant business comes online and sales at SK Showa Denko expand. We reiterate BUY on the stock, but we lower our 12-month target price to KRW200,000 in consideration of industry conditions.

4Q review—SK Airgas enjoys noteworthy top-line growth: SK Materials' 4Q operating profit (KRW57.1b) just edged our estimate (KRW56b). Operating results were influenced by lackluster industry conditions from December, but sales at subsidiary SK Airgas grew out faster than we expected.

1Q outlook—operating profit to confirm low earnings volatility: Anemic conditions in the semiconductor industry should have a greater impact on SK Materials' performance in 1Q. In its 2019 guidance, the firm cut its special-gas shipment target by around 5% and said some products are experiencing ASP declines. Nonetheless, we believe 1Q operating results will prove how limited its earnings downside is. First, the firm's ability to defend prices has been remarkable amidst NF₃ market consolidation. SK Materials and its rivals put the brakes on capacity expansions last year. Second, its product portfolio has expanded mainly based on sales to captive clients.

Valuation: There is a high correlation between estimated ROE and the P/B multiple at which SK Materials shares are trading. Historically speaking, a 12-month estimated ROE of 25-30% suggests a fair P/B of 3.8x. Because of downstream sluggishness, however, some discount seems necessary. Applying a 15% discount (half of the level we used in Dec 2018 based on our gloomy semiconductor industry outlook), we revise down our 12-month target price to KRW200,000.

SUMMARY OF 4Q RESULTS

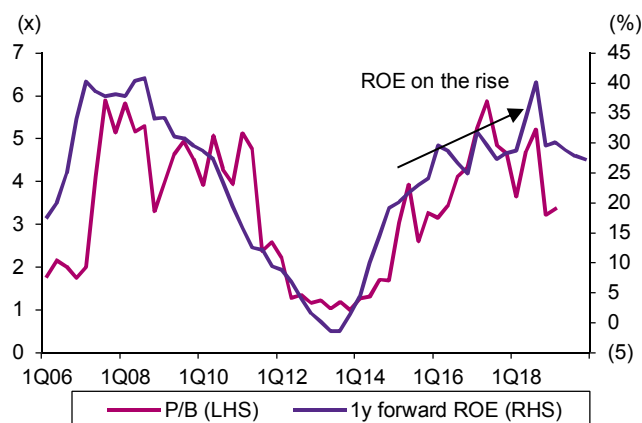
(KRWb)	4Q18	Chg		Diff (%)	
		(% y-y)	(% q-q)	Samsung	Consensus
Sales	201.5	43.7	8.3	4.3	3.5
Operating profit	57.1	56.2	11.5	2.0	4.0
Pre-tax profit	48.0	50.3	9.4	(10.2)	(0.9)
Net profit	36.4	30.9	(5.6)	(19.7)	(5.5)
Margins (%)					
Operating profit	28.3				
Pre-tax profit	23.8				
Net profit	18.1				

Source: Company data, Samsung Securities estimates

VALUATION SUMMARY

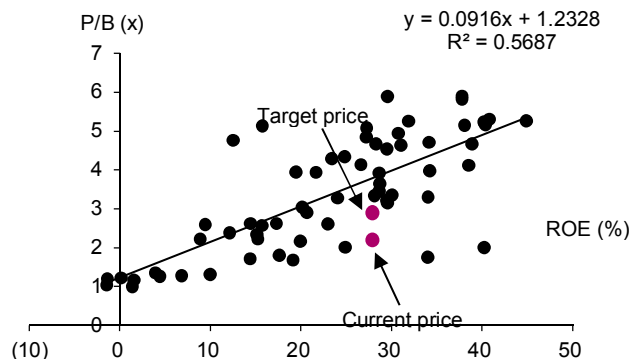
	2017	2018	2019E
Multiples (x)			
P/E	16.2	13.6	11.3
P/B	4.1	3.2	2.6
EV/EBITDA	9.8	8.1	6.8
Div yield (%)	2.3	2.4	2.7
EPS growth (% y-y)	(6.2)	19.1	20.6
ROE (%)	25.3	28.3	27.8
Per-share data (KRW)			
EPS	9,660	11,507	13,882
BVPS	38,502	49,697	61,379
DPS	3,550	3,750	4,250

Quarterly P/B and forward ROE



Source: WiseFn, Samsung Securities

P/B (based on current price) vs ROE



Source: WiseFn, Samsung Securities

Quarterly results

(KRWb)	4Q18	3Q18	4Q17	Chg	
				(% q-q)	(% y-y)
Sales	201.5	186.0	140.2	8.3	43.7
Operating profit	57.1	51.2	36.5	11.5	56.4
Pre-tax profit	48.0	23.6	22.8	103.4	110.7
Net profit	36.4	20.7	19.8	75.6	83.5
Margins (%)					
Operating profit	28.4	27.5	26.1		
Pre-tax profit	23.8	12.7	16.3		
Net profit	18.1	11.1	14.1		

Source: Company data, Samsung Securities estimates

Revisions to full-year forecasts

(KRWb)	Old		New		Chg (%)	
	2018E	2019E	2018E	2019E	2018E	2019E
Sales	679.0	783.0	687.3	793.0	1.2	1.3
Operating profit	181.8	218.1	182.9	218.0	0.6	(0.1)
Pre-tax profit	161.7	201.7	159.3	192.0	(1.5)	(4.8)
Net profit	130.4	157.3	124.0	149.5	(4.9)	(4.9)

Source: Samsung Securities estimates

Target price calculation

(KRW)	2019E
BVPS*	61,379
ROE (%)	27.8
Target P/B (x)	3.8
Discount (%)	15.0
Fair value	197,113
Target price	200,000
Current price	156,600
Upside (%)	27.7

Note: *Excludes treasury holdings

Source: Samsung Securities estimates

Results and forecasts

(KRWb)	1Q18	2Q18	3Q18	4Q18	1Q19E	2Q19E	3Q19E	4Q19E	2017	2018E	2019E
Sales	142.3	157.5	186.0	201.5	194.9	198.0	200.7	199.3	512.3	687.3	793.0
NF ₃	78.0	79.1	89.6	90.9	87.1	85.4	85.0	87.1	310.3	337.6	344.5
SiH ₄	8.3	8.7	9.2	9.4	8.2	8.5	8.4	8.6	34.0	35.5	33.6
SK Airgas	25.4	27.9	31.8	38.2	40.1	40.9	41.8	37.6	91.4	123.3	160.4
JV	4.2	10.7	22.7	29.1	27.7	29.1	29.8	30.8	1.5	66.7	117.5
Other	26.5	31.1	32.7	33.9	31.7	34.1	35.8	35.3	75.0	124.2	137.0
Operating profit	33.8	40.8	51.2	57.1	54.3	55.6	54.3	53.8	147.7	182.9	218.0
NF ₃	13.4	15.6	21.7	24.9	20.1	19.2	17.2	18.2	89.2	75.6	74.7
SiH ₄	(1.1)	(1.0)	(0.6)	(0.6)	(1.1)	(1.0)	(1.0)	(1.1)	(3.8)	(3.3)	(4.2)
SK Airgas	5.5	6.0	7.4	9.9	10.3	10.6	10.9	9.5	20.1	28.8	41.2
JV	0.5	2.0	6.2	7.1	7.2	7.6	7.8	8.1	(0.1)	15.8	30.7
Other	15.6	18.1	16.5	15.8	17.8	19.2	19.4	19.1	42.2	66.0	75.6
Pre-tax profit	31.3	36.1	43.9	48.0	48.0	49.5	48.3	46.1	134.5	159.3	192.0
Net profit	22.8	26.2	38.5	36.4	36.0	37.1	36.7	39.6	104.1	124.0	149.5
Margins (%)											
Operating profit	23.7	25.9	27.5	28.4	27.9	28.1	27.0	27.0	28.8	26.6	27.5
Pre-tax profit	22.0	22.9	23.6	23.8	24.6	25.0	24.1	23.1	26.3	23.2	24.2
Net profit	16.1	16.6	20.7	22.2	19.5	19.9	19.4	21.6	20.3	19.2	20.1

Source: Company data; Samsung Securities estimates

Income statement

Year-end Dec 31 (KRWb)	2016	2017	2018E	2019E	2020E
Sales	461	512	687	793	860
Cost of goods sold	269	315	430	497	527
Gross profit	193	198	257	296	333
Gross margin (%)	41.8	38.6	37.4	37.4	38.7
SG&A expenses	39	50	74	78	83
Operating profit	154	148	183	218	250
Operating margin (%)	33.4	28.8	26.6	27.5	29.0
Non-operating gains (losses)	(14)	(13)	(24)	(26)	(24)
Financial profit	20	14	9	6	6
Financial costs	23	26	29	27	25
Equity-method gains (losses)	0	(0)	0	0	0
Other	(10)	(2)	(3)	(5)	(5)
Pre-tax profit	140	135	159	192	226
Taxes	30	30	35	42	50
Effective tax rate (%)	21.3	22.6	22.2	22.1	22.2
Profit from continuing operations	110	104	124	150	176
Profit from discontinued operations	0	0	0	0	0
Net profit	110	104	124	150	176
Net margin (%)	23.9	20.3	18.0	18.9	20.4
Net profit (controlling interests)	109	102	121	146	172
Net profit (non-controlling interests)	2	2	3	3	4
EBITDA	222	223	264	302	336
EBITDA margin (%)	48.0	43.5	38.4	38.1	39.1
EPS (parent-based) (KRW)	10,299	9,660	11,507	13,882	16,323
EPS (consolidated) (KRW)	10,472	9,866	11,752	14,177	16,670
Adjusted EPS (KRW)*	10,299	9,660	11,507	13,882	16,323

Cash flow statement

Year-end Dec 31 (KRWb)	2016	2017	2018E	2019E	2020E
Cash flow from operations	208	137	213	236	264
Net profit	110	104	124	150	176
Non-cash profit and expenses	115	123	137	148	155
Depreciation	67	74	80	83	86
Amortization	1	1	1	1	1
Other	47	48	56	63	69
Changes in A/L from operating activities	17	(46)	6	0	0
Cash flow from investments	(209)	(268)	(132)	(102)	(102)
Change in tangible assets	(125)	(261)	(130)	(100)	(100)
Change in financial assets	(1)	1	(0)	(0)	(0)
Other	(83)	(9)	(1)	(2)	(2)
Cash flow from financing	19	92	54	(166)	(100)
Change in debt	118	214	90	(130)	(60)
Change in equity	(33)	(0)	0	0	0
Dividends	(30)	(37)	(36)	(36)	(40)
Other	(35)	(84)	(0)	0	0
Change in cash	19	(42)	132	(35)	60
Cash at beginning of year	41	60	19	151	116
Cash at end of year	60	19	151	116	177
Gross cash flow	225	227	261	297	331
Free cash flow	82	(124)	83	136	164

Note: * Excluding one off items, ** Fully diluted, excluding one-off items

*** From companies subject to equity-method valuation

Source: Company data, Samsung Securities estimates

Balance sheet

Year-end Dec 31 (KRWb)	2016	2017	2018E	2019E	2020E
Current assets	217	202	381	382	465
Cash & equivalents	60	19	151	116	177
Accounts receivable	72	83	104	120	130
Inventories	74	86	108	124	135
Other current assets	11	14	19	22	24
Fixed assets	686	916	969	987	1,002
Investment assets	1	11	15	18	19
Tangible assets	661	885	935	951	966
Intangible assets	7	7	6	5	4
Other long-term assets	17	13	13	13	13
Total assets	903	1,118	1,350	1,370	1,468
Current liabilities	284	337	463	374	344
Accounts payable	22	27	33	38	41
Short-term debt	51	149	139	89	39
Other current liabilities	210	161	292	248	264
Long-term liabilities	182	373	391	385	378
Bonds & long-term debt	150	352	362	352	342
Other long-term liabilities	32	21	29	33	36
Total liabilities	466	710	854	759	722
Owners of parent equity	421	386	472	582	714
Capital stock	5	5	5	5	5
Capital surplus	34	34	34	34	34
Retained earnings	383	446	532	643	775
Other	(1)	(100)	(100)	(100)	(100)
Non-controlling interests' equity	16	22	25	28	32
Total equity	437	408	497	610	746
Net debt	256	512	470	374	254

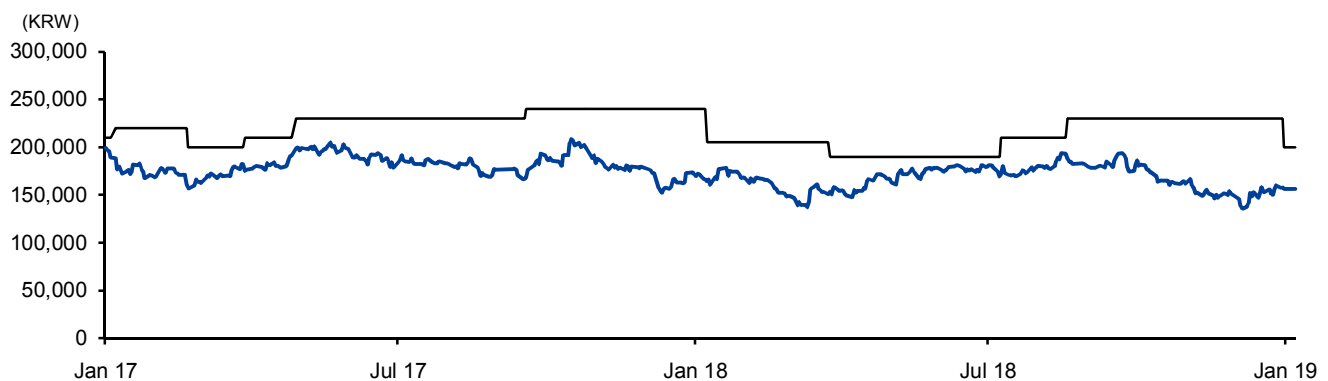
Financial ratios

Year-end Dec 31	2016	2017	2018E	2019E	2020E
Growth (%)					
Sales	36.5	11.0	34.2	15.4	8.4
Operating profit	36.6	(4.2)	23.9	19.2	14.5
Net profit	67.0	(5.8)	19.1	20.6	17.6
Adjusted EPS**	64.3	(6.2)	19.1	20.6	17.6
Per-share data (KRW)					
EPS (parent-based)	10,299	9,660	11,507	13,882	16,323
EPS (consolidated)	10,472	9,866	11,752	14,177	16,670
Adjusted EPS**	10,299	9,660	11,507	13,882	16,323
BVPS	39,996	38,502	49,697	61,379	75,276
DPS (common)	3,550	3,550	3,750	4,250	4,500
Valuations (x)					
P/E***	15.2	16.2	13.6	11.3	9.6
P/B***	3.9	4.1	3.2	2.6	2.1
EV/EBITDA	8.7	9.8	8.1	6.8	5.8
Ratios (%)					
ROE	27.2	25.3	28.3	27.8	26.6
ROA	14.1	10.3	10.0	11.0	12.4
ROIC	19.5	14.0	15.1	17.3	19.5
Payout ratio	34.4	34.9	29.3	27.5	24.8
Dividend yield (common)	2.3	2.3	2.4	2.7	2.9
Net debt to equity	58.6	125.6	94.7	61.3	34.0
Interest coverage (x)	15.4	11.4	9.2	10.7	13.8

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Target price changes in past two years



Rating changes over past two years (adjusted share prices)

Date	2016/12/20	2017/2/5	3/23	4/27	5/29	10/18	2018/2/7	4/24	8/8	9/18	2019/1/30
Recommendation	BUY	BUY	BUY	BUY	BUY	BUY	BUY	BUY	BUY	BUY	BUY
Target price (KRW)	210,000	220,000	200,000	210,000	230,000	240,000	205,000	190,000	210,000	230,000	200,000
Gap* (average)	(12.02)	(20.55)	(14.75)	(13.52)	(18.93)	(25.16)	(22.33)	(10.38)	(14.98)	(28.25)	
(max or min)**	(5.05)	(14.32)	(8.60)	(9.10)	(10.87)	(13.04)	(13.12)	(4.37)	(7.71)	(15.87)	

Note: * [(average, maximum, or minimum share price over duration of target price minus target price) / target price] x 100%

** Maximum/minimum share price if new target is higher/lower than market close on the business day prior to target price change

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Industry

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Percentage of ratings in 12 months prior to Dec 31, 2018

BUY (83.3%) | HOLD (16.7%) | SELL (0%)

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