

# Sungkwang Bend (014620 KQ)

Lee Dong-heon

dongheon.lee@daishin.com

Rating

MARKETPERFORM

maintain

6M TP (W)

12,000

maintain

CP (W)

11,100

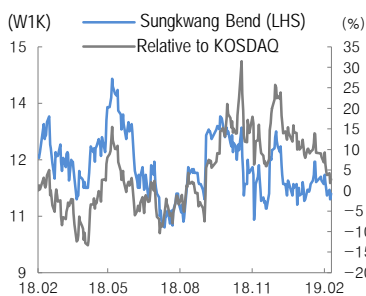
(19.02.20)

Machinery

Industry 4.0 safety rating ■ Neutral Green

KOSDAQ	750.69
Market cap (Wbn)	317
Market cap portion (%)	0.12
Paid-in capital (common; Wbn)	14
52w high/low (W)	14,150 / 10,200
120d avg. trading volume (Wbn)	2.1
Foreign ownership (%)	15.43
Major shareholders	An Jae-il: 41.08%
	Somerset Capital Management LLP 9.69%

(%)	1M	3M	6M	12M
Abs. return	1.4	-6.3	-0.9	-11.6
Rel. return	-6.0	-13.8	1.6	1.8



## In a rough patch

### MARKETPERFORM; TP maintained at W12,000

- Our W12,000 target price for the fittings maker is based on the 2019E BPS of W15,149 and a target P/B ratio of 0.8x, a 20% premium to the company's five-year average multiple. The valuation premium reflects the company's strong asset value and signs of improvements after a protracted growth funk.

\* Previously, we derived our target price from a residual income model assuming a risk-free interest rate of 2.1%, risk premium of 5.0%, and 52-week beta of 0.54.

### 4Q18 review

- In its preliminary fourth-quarter earnings report, Sungkwang Bend said it swung to an operating loss of W6.9bn, far worse than our estimate (a W900mn loss) and the consensus forecast (a W2.3bn loss).
- The company blamed the miss on lower selling prices as a result of stiff competition, incentive payouts (W1.1bn), and higher material (up by W2.5bn) and labor (up by W400mn) costs.
- We expect the stretch of losses, which has continued for the eighth consecutive quarter, to extend to 1Q20, instead of 1Q19 as we previously projected.
- Revenue jumped 56% yoy to W49.3bn, largely in line with our expectation (W48.5bn) and the market's view (W47.4bn), buoyed by increased shipments in the year-end quarter.
- This year, the company is expected to book W224.5bn in new orders (up 15.5% yoy), down from our previous estimate of W233.8bn.

### On a recovery path

- Domestic oil refiners are set to ramp up capital investment as oil prices start to pick up. Orders for new plants are also expected to rise globally. Those prospects solidly put Sungkwang Bend, which enjoys oligopoly status in the global welding fitting market, in recovery mode.
- Further brightening the outlook, the industrial parts supplier is in a net cash position (higher than W50bn) and its stock is trading at rock-bottom levels (with a P/B ratio of 0.7-0.8).
- Investors, however, should be mindful of the following: 1) Oil prices are stabilizing, but at lower levels than in the past; 2) It takes time for oil refiners' increased capital expenses to find their way to the company's coffer; and 3) Local shipbuilders, a high-margin customer group, is slashing investment in offshore rigs.

(Wbn, %)										
	4Q17	3Q18	4Q18					1Q19		
			Previous estimate	Result	YoY	QoQ	Consensus	Daishin estimate	YoY	QoQ
Revenue	32	43	49	49	56.0	15.6	47	47	28.4	-5.1
OP	-11	-5	-1	-7	CL	CL	-2	-1	CL	CL
NP	-9	-4	-1	-5	CL	CL	-3	-1	CL	CL

	2016	2017	2018(F)				Growth	
			Previous estimate	Daishin estimate	Change	Consensus	2017	2018(F)
Revenue	203	146	169	170	0.5	169	-28.2	16.6
OP	3	-19	-9	-15	CL	-10	TTR	CL
NP	5	-16	-6	-9	CL	-5	TTR	CL

Source: Sungkwang Bend, FnGuide, Daishin Securities Research Center

Operating results and major financial data

(Wbn, W, x, %)					
	2016A	2017A	2018F	2019F	2020F
Revenue	203	146	170	191	221
OP	3	-19	-15	-5	4
Pretax profit	6	-24	-11	-4	6
NP	5	-16	-9	-3	4
NP (controlling int.)	5	-16	-9	-3	4
EPS	159	-571	-304	-98	154
PER	55.5	NA	NA	NA	72.2
BPS	16,401	15,747	15,345	15,149	15,205
PBR	0.5	0.6	0.7	0.7	0.7
ROE	1.0	-3.5	-2.0	-0.6	1.0

Note: EPS, BPS, and ROE are based only on the controlling interest.  
Source: Sungkwang Bend, Daishin Securities Research Center

Earnings forecast revision

(Wbn, W, %, %p)						
	Previous		Revised		Chg	
	2018F	2019F	2018F	2019F	2018F	2019F
Revenue	169	199	170	191	0.5	-3.9
SG&A expense	29	26	29	26	3.1	0.0
OP	-9	1	-15	-5	CL	adj. to loss
OP margin	-5.3	0.7	-8.8	-2.8	CL	adj. to loss
Non-operating profit	2	2	4	2	77.1	0.0
Pretax profit	-7	3	-11	-4	CL	adj. to loss
NP (controlling int.)	-6	2	-9	-3	CL	adj. to loss
NP margin	-3.3	1.2	-5.1	-1.5	CL	adj. to loss
EPS (controlling int.)	-194	82	-304	-98	CL	adj. to loss

Source: Sungkwang Bend, Daishin Securities Research Center

Earnings projection (revised)										(Wbn)		
	2017	2018P	2019E	2020E	1Q18	2Q18	3Q18	4Q18P	1Q19E	2Q19E	3Q19E	4Q19E
Order intakes	172.1	194.4	224.5	262.7	54.1	45.1	50.2	45.0	57.4	53.2	57.7	56.3
HQ	147.9	163.8	185.5	217.1	45.9	36.3	43.6	38.0	49.7	43.8	49.6	47.9
Hwajin PF	24.2	30.6	39.0	45.6	8.3	8.7	6.6	7.0	7.7	9.3	8.1	8.4
yoy (%)	0.2	12.9	15.5	17.0	27.3	16.9	23.5	-10.8	6.0	18.0	15.0	25.0
HQ	0.0	10.7	13.3	17.0	22.2	11.9	25.8	-12.2	8.2	20.6	13.9	26.0
Hwajin PF	1.3	26.3	27.4	17.0	65.8	43.7	10.2	-2.3	-6.3	7.0	21.9	19.6
Order backlogs(HQ)	60.0	86.7	120.1	162.1	91.3	90.4	94.4	86.7	94.1	92.7	98.5	103.2
yoy	31.7	44.5	38.6	35.0	78.5	95.7	109.0	44.5	3.0	2.5	4.3	19.0
Order intakes/ Revenue(%)	118.1	114.4	117.5	119.0	148.6	108.6	117.7	91.3	122.7	107.1	121.6	119.1
Revenue	145.7	169.9	191.1	220.7	36.4	41.5	42.6	49.3	46.8	49.6	47.4	47.2
yoy	-28.2	16.6	12.5	15.5	4.1	2.7	10.1	56.0	28.4	19.6	11.2	-4.2
HQ	133.5	155.1	169.9	197.8	32.6	37.2	39.5	45.7	42.3	45.2	43.8	43.2
Hwajin PF	21.2	26.5	35.0	37.4	6.5	7.4	5.5	7.1	7.9	7.8	7.1	7.5
Internal sales	-9.0	-11.7	-13.8	-14.5	-2.7	-3.1	-2.3	-3.5	-3.5	-3.5	-3.5	-3.5
Exports	86.1	100.7	115.0	133.5	19.3	24.2	26.9	30.3	28.2	29.9	28.6	28.4
Domestic sales	59.7	69.1	76.1	87.2	17.1	17.3	15.8	19.0	18.6	19.8	18.9	18.8
Export (%)	59.1	59.3	60.2	60.5	53.0	58.4	63.0	61.5	60.2	60.2	60.2	60.2
Domestic sales (%)	40.9	40.7	39.8	39.5	47.0	41.6	37.0	38.5	39.8	39.8	39.8	39.8
COGS	140.2	155.4	171.0	189.8	30.9	37.5	38.8	48.3	42.0	44.8	42.9	41.3
COGS / revenue (%)	96.2	91.5	89.5	86.0	84.8	90.2	91.0	97.9	89.7	90.4	90.4	87.5
GP	5.5	14.5	20.1	30.9	5.5	4.1	3.8	1.0	4.8	4.8	4.6	5.9
yoy (%)	-82.6	161.0	15.0	15.0	33.7	28.4	92.2	-127.1	-13.3	18.2	18.8	477.5
GP margin (%)	3.8	8.5	10.5	14.0	15.2	9.8	9.0	2.1	10.3	9.6	9.6	12.5
S&A expense	24.2	29.4	25.5	26.5	6.3	6.7	8.5	7.9	6.2	6.6	6.3	6.3
Share (%)	16.6	17.3	13.3	12.0	17.3	16.2	20.0	16.0	13.3	13.3	13.3	13.3
OP	-18.6	-14.9	-5.4	4.4	-0.7	-2.7	-4.7	-6.9	-1.4	-1.8	-1.8	-0.4
yoy (%)	-744.2	-19.8	-63.6	-181.0	-34.6	31.6	8.5	-38.6	92.7	-31.1	-62.3	-94.1
OP margin (%)	-12.8	-8.8	-2.8	2.0	-2.0	-6.4	-11.0	-13.9	-3.1	-3.7	-3.7	-0.9

Source: Sungkwang Bend, Daishin Securities Research Center

Earnings projection (previous)

(Wbn)

	2017	2018E	2019E	2020E	1Q18	2Q18	3Q18P	4Q18E	1Q19E	2Q19E	3Q19E	4Q19E
Order intakes	172.1	203.3	233.8	273.5	54.1	45.1	50.2	53.9	62.3	51.8	57.7	61.9
HQ	147.9	171.8	194.8	227.9	45.9	36.3	43.6	46.0	53.9	42.7	49.6	53.0
Hwajin PF	24.2	31.5	39.0	45.6	8.3	8.7	6.6	7.9	8.4	9.1	8.1	8.9
yoy (%)	0.2	18.1	15.0	17.0	27.3	16.9	23.5	6.8	15.0	15.0	15.0	15.0
HQ	0.0	16.1	13.4	17.0	22.2	11.9	25.8	6.3	17.4	17.6	13.9	15.3
Hwajin PF	1.3	29.9	23.9	17.0	65.8	43.7	10.2	9.8	1.6	4.3	21.9	13.4
Order backlogs(HQ)	60.0	96.6	131.4	175.1	91.3	90.4	94.4	96.6	106.4	102.0	105.9	114.7
yoy	31.7	61.0	36.0	33.3	78.5	95.7	109.0	61.0	16.5	12.8	12.2	18.8
Order intakes/ Revenue(%)	118.1	120.2	117.5	119.0	148.6	108.6	117.7	111.1	127.7	100.2	116.7	126.4
Revenue	145.7	169.1	198.9	229.8	36.4	41.5	42.6	48.5	48.8	51.7	49.5	49.0
yoy	-28.2	16.0	17.7	15.5	4.1	2.7	10.1	53.5	33.8	24.6	16.0	1.1
HQ	133.5	153.2	177.7	205.3	32.6	37.2	39.5	43.8	44.1	47.1	45.7	44.2
Hwajin PF	21.2	27.6	35.0	39.0	6.5	7.4	5.5	8.2	8.1	8.0	7.2	8.3
Internal sales	-9	-12	-14	-15	-3	-3	-2	-4	-3	-3	-3	-3
Exports	86.1	100.2	119.8	139.0	19.3	24.2	26.9	29.8	29.3	31.1	29.8	29.5
Domestic sales	59.7	68.8	79.2	90.8	17.1	17.3	15.8	18.7	19.4	20.6	19.7	19.5
Export (%)	59.1	59.3	60.2	60.5	53.0	58.4	63.0	61.5	60.2	60.2	60.2	60.2
Domestic share (%)	40.9	40.7	39.8	39.5	47.0	41.6	37.0	38.5	39.8	39.8	39.8	39.8
COGS	140.2	149.6	172.1	197.6	30.9	37.5	38.8	42.4	42.0	44.8	42.9	42.4
COGS / revenue (%)	96.2	88.5	86.5	86.0	84.8	90.2	91.0	87.5	86.1	86.7	86.7	87.5
GP	5.5	19.5	26.9	32.2	5.5	4.1	3.8	6.1	6.8	6.9	6.6	6.6
yoy (%)	-82.6	252.0	15.0	15.0	33.7	28.4	92.2	-261.1	22.2	70.0	70.9	9.1
GP margin (%)	3.8	11.5	13.5	14.0	15.2	9.8	9.0	12.5	13.9	13.3	13.3	13.5
S&A expense	24.2	28.5	25.5	26.5	6.3	6.7	8.5	7.0	6.2	6.6	6.3	6.3
Share (%)	16.6	16.9	12.8	11.5	17.3	16.2	20.0	14.4	12.8	12.8	12.8	12.8
OP	-18.6	-9.0	1.4	5.7	-0.7	-2.7	-4.7	-0.9	0.5	0.3	0.2	0.3
yoy (%)	-744.2	-51.6	-115.1	317.7	-34.6	31.6	8.5	-91.6	-171.7	-109.5	-105.1	-135.7
OP margin (%)	-12.8	-5.3	0.7	2.5	-2.0	-6.4	-11.0	-1.9	1.1	0.5	0.5	0.7

Source: Sungkwang Bend, Daishin Securities Research Center

Company profile

Overview

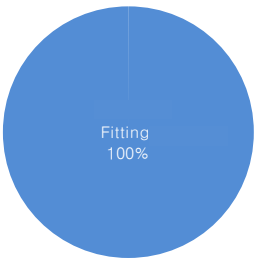
- Manufactures welding fittings for use in petrochemical plants, offshore plants, and power plants
- Assets W505.9bn, liabilities W62.1bn, equities W443.8bn
- # of outstanding shares: 28,600,000 / # of treasury shares: 671,453
- 2017 payout ratio: -17.1% (2016: 91.8%, 2015: 21.5%)

Share price catalysts

- Change in order intakes, which are affected by oil price movements
- Power plan projects in the Middle East
- Capex at domestic refineries

Source: Sungkwang Bend, Daishin Securities Research Center

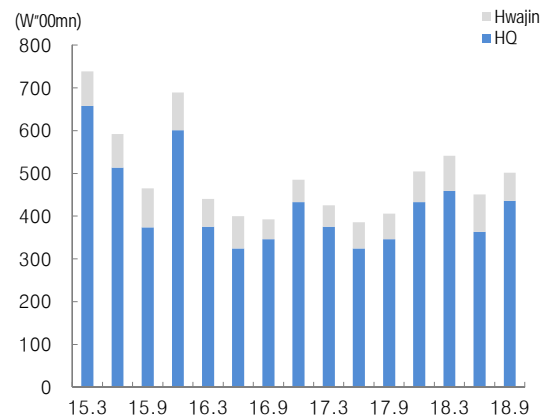
Revenue mix



Source: Sungkwang Bend, Daishin Securities Research Center

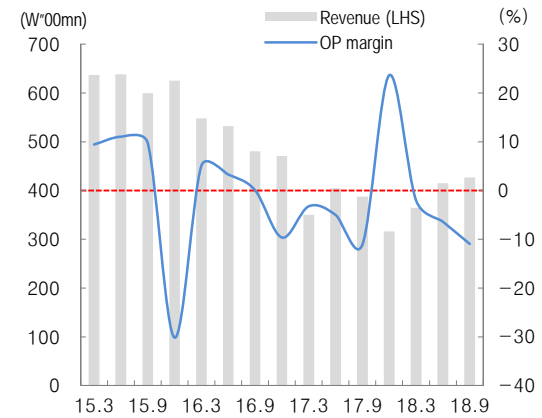
Earnings drivers

Order intakes by quarter



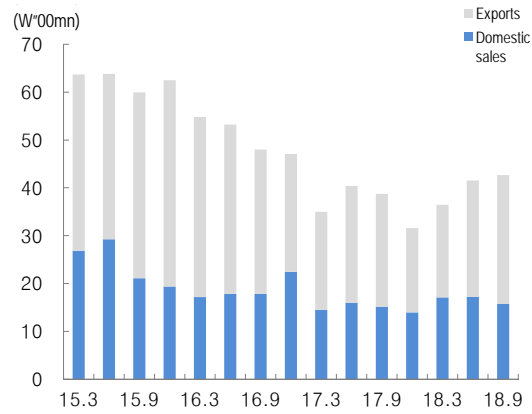
Source: Sungkwang Bend, Daishin Securities Research Center

Quarterly revenue and OP margin



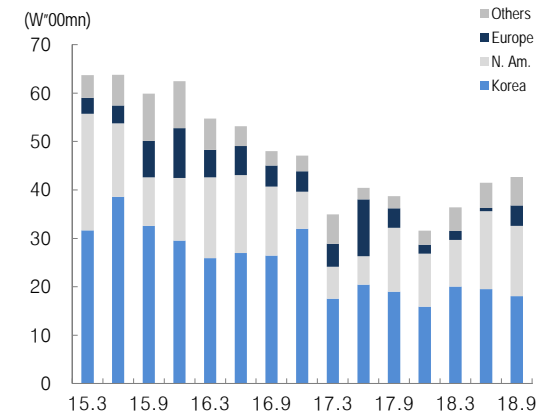
Source: Sungkwang Bend, Daishin Securities Research Center

Quarterly domestic sales vs. exports



Source: Sungkwang Bend, Daishin Securities Research Center

Customer breakdown by region



Source: Sungkwang Bend, Daishin Securities Research Center

Financial statements

Income statement					(Wbn)
	2016A	2017A	2018F	2019F	2020F
Revenue	203	146	170	191	221
Cost of goods sold	171	140	155	171	190
Gross profit	32	6	14	20	31
S&A expenses	29	24	29	26	27
OP	3	-19	-15	-5	4
OP margin	1.4	-12.8	-8.8	-2.8	2.0
EBITDA	7	-15	-12	-2	8
Non-OP	3	-6	4	2	1
Income from affiliates	0	0	0	0	0
Financial revenue	1	1	0	1	1
FX related gains	4	1	0	3	4
Financial expense	0	0	0	0	0
FX related losses	0	0	0	0	0
Others	3	-7	4	1	1
Income before taxes	6	-24	-11	-4	6
Income tax expense	-2	8	2	1	-1
Income from cont. op.	5	-16	-9	-3	4
Income from discnt. op.	0	0	0	0	0
NP	5	-16	-9	-3	4
NP margin	2.2	-11.2	-5.1	-1.5	2.0
NP for non-contr. interest	0	0	0	0	0
NP for contr. interest	5	-16	-9	-3	4
Valuation of AFS fin. assets	0	0	0	0	0
Other compreh. income	3	2	2	2	3
Comprehensive income	8	-14	-6	0	7
Comp. income for non-contr. int.	0	0	0	0	0
Comp. income for contr. int.	8	-14	-6	0	7

Valuation metrics					(W, x, %)
	2016A	2017A	2018F	2019F	2020F
EPS	159	-571	-304	-98	154
PER	55.5	NA	NA	NA	72.2
BPS	16,401	15,747	15,345	15,149	15,205
PBR	0.5	0.6	0.7	0.7	0.7
EBITDAPS	231	-525	-405	-71	276
EV/EBITDA	28.8	NA	NA	NA	36.1
SPS	7,100	5,096	5,940	6,682	7,717
PSR	12	2.0	1.9	1.7	1.4
CFPS	355	-456	-91	69	408
DPS	150	100	100	100	100

Financial ratios					(W, x, %)
	2016A	2017A	2018F	2019F	2020F
Growth potential					
Revenue growth	-18.7	-28.2	16.6	12.5	15.5
OP growth	-87.3	TTR	CL	CL	TTB
NP growth	-76.6	TTR	CL	CL	TTB
Profitability					
ROIC	0.5	-3.1	-3.0	-1.0	0.8
ROA	0.5	-3.6	-3.0	-1.1	0.9
ROE	1.0	-3.5	-2.0	-0.6	1.0
Stability					
Debt ratio	135	11.6	13.4	15.2	17.0
Net borrowings ratio	-135	-15.0	-11.2	-9.2	-7.5
Interest coverage ratio	35.1	-418.1	0.0	0.0	0.0

Source: Sungkwang Bend, Daishin Securities Research Center

Balance sheet					(Wbn)
	2016A	2017A	2018F	2019F	2020F
Current assets	272	247	242	241	247
Cash & cash equiv.	59	37	31	24	37
Trade & other receive.	62	50	47	53	58
Inventories	127	110	121	119	123
Other current assets	23	50	42	44	29
Long-term assets	260	256	256	258	262
Tangible assets	252	250	250	252	255
Investments in affiliates	0	0	0	0	0
Other long-term assets	8	6	6	6	7
Total assets	532	502	498	499	509
Current liabilities	43	40	46	53	60
Payables & other liab.	22	20	21	23	26
Borrowings	19	19	24	29	33
Current portion of LT debts	0	0	0	0	0
Other current liabilities	1	1	1	1	1
Long-term liabilities	20	12	13	13	14
Borrowings	0	0	0	0	0
Convertible securities	0	0	0	0	0
Other long-term liab.	20	12	13	13	14
Total liabilities	63	52	59	66	74
Controlling interest	469	450	439	433	435
Capital stock	14	14	14	14	14
Capital surplus	4	4	4	4	4
Retained earnings	464	446	434	429	430
Other capital changes	-13	-14	-14	-14	-14
Non-controlling interest	0	0	0	0	0
Total shareholder's equity	469	450	439	433	435
Net borrowings	-63	-67	-49	-40	-33

Cash flow statement					(Wbn)
	2016A	2017A	2018F	2019F	2020F
Operating cash flows	39	11	-10	-1	3
NP	5	-16	-9	-3	4
Non-cash items	6	3	6	5	7
Depreciation	4	4	3	3	3
FX gains	-1	5	2	-1	-1
Equity method gain	0	0	0	0	0
Others	2	-6	1	2	4
Chg in assets & liab.	33	24	-9	-4	-8
Other cash flows	-4	-1	2	1	-1
Investing cash flow	-5	-25	4	-8	8
Investment assets	-3	-2	0	0	0
Tangible assets	0	0	-3	-5	-7
Others	-2	-23	7	-2	15
Financing cash flows	-13	-4	1	2	2
Short-term borrowings	12	1	5	5	5
Bonds payable	0	0	0	0	0
Long-term borrowings	0	0	0	0	0
Rights offering	0	0	0	0	0
Cash dividends	-4	-4	-3	-3	-3
Others	-21	-1	-1	0	0
Net chg in cash	20	-22	-7	-7	13
Beginning cash balance	39	59	37	31	24
Ending cash balance	59	37	31	24	37
NOPLAT	2	-13	-12	-4	3
FCF	5	-9	-12	-6	0

[Daishin House View: Industry 4.0 safety rating]

- Daishin Securities assigns safety ratings to individual sectors and companies based on analyses and discussions by our analysts.
- Depending on whether Industry 4.0 will have a positive, neutral, or negative impact, each industry and company is assigned one of three safety ratings:

Dark Gray (negative)	Neutral Green (neutral)	Sky Blue (positive)
----------------------	-------------------------	---------------------

[Compliance Notice]

In accordance with Subparagraph 5 of Paragraph 1 of Article 4-20 of the supervisory regulations for the financial investment industry, we confirm that no information or content has been shared prior to its release on Daishin's website, and that the analyst has not received nor will receive direct or indirect compensation in exchange for expressing specific opinions. Daishin is not affiliated with the company presented in this report. This report has been presented without any undue external influence or interference, and accurately reflects the personal views of the analyst who is responsible for its content.

This report is distributed for the purpose of helping investors make informed decisions. This report has been prepared from the data and information believed to be correct and reliable, but Daishin Securities does not make any guarantee as to the accuracy thereof. Investors reading this report should make final decisions based on their own judgment.

**For U.S. persons only:** For U.S. persons only: This independent third party research report is a product of Daishin Securities, which is the employer of the research analyst(s) who has prepared the research report. The research analyst(s) preparing the research report is/are resident outside the United States (U.S.) and are not associated persons of any U.S. regulated broker-dealer and therefore the analyst(s) is/are not subject to supervision by a U.S. broker-dealer, and is/are not required to satisfy the regulatory licensing requirements of FINRA or required to otherwise comply with U.S. rules or regulations regarding, among other things, communications with a subject company, public appearances and trading securities held by a research analyst account.

This independent third-party research report is distributed in the United States ("US") to Major US Institutional Investors (as defined in Rule 15a-6 under the Securities and Exchange Act of 1934, as amended) by Maybank Kim Eng Securities USA Inc. ("Maybank KESUSA") and Auerbach Grayson and Company LLC, broker-dealers registered in the US (registered under Section 15 of the Securities Exchange Act of 1934, as amended). All responsibility for the distribution of this report by Maybank KESUSA in the US shall be borne by Maybank KESUSA. All responsibility for the distribution of this report by Auerbach Grayson and Company LLC shall be borne by Auerbach Grayson and Company LLC.

If the recipient of this report is not a Major Institutional Investor as specified above, then it should not act upon this report and return the same to the sender. Further, this report may not be copied, duplicated and/or transmitted onward to any U.S. person, which is not the Major Institutional Investor. In reliance on the exemption from registration provided by Rule 15a-6 of the Exchange Act and interpretations thereof by the SEC in order to conduct certain business with Major Institutional Investors, Daishin Securities has entered into an agreement with two U.S. registered broker-dealers, Maybank Kim Eng Securities USA Inc and Auerbach Grayson and Company LLC. All U.S. persons receiving and/or accessing this report and wishing to effect transactions in any security mentioned within must do so with: Maybank Kim Eng Securities USA Inc. 777 Third Avenue 21st Floor New York, New York 1- (212) 688-8886 or Auerbach Grayson and Company LLC 25 West 45th Street, New York, NY 10036 and not with the issuer of this report.

**Analyst Certification of Independence**

The views expressed in this research report accurately reflect the analyst's personal views about any and all of the subject securities or issuers; and no part of the research analyst's compensation was, is or will be, directly or indirectly, related to the specific recommendations or views expressed in this report.

[Investment rating & Target price history]

