[Korea] IT Services

May 31, 2023

Samsung SDS

(018260 KS)

All eyes on the cloud business

Buy
(Initiate)

TP: W185,000
Upside: 48.1%

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Earnings outlook

2023 revenue to fall 16.8% YoY (to W14.34tr) on widely expected drop in logistics rates

- We forecast Samsung SDS's 2023 logistics revenue to fall 30% YoY to W7.86tr. A decline in revenue seems inevitable, as rates are stabilizing downward after surging amid the pandemic.
- On the other hand, we expect IT services to continue solid growth in 2023, with revenue of W6.41tr (+7.5% YoY). The cloud business should be the biggest contributor; we forecast cloud revenue to jump 50.4% YoY to W1.75tr.
- We forecast 2023 operating profit at W823bn (-10.1% YoY; OP margin of 5.7%). A slower increase in labor costs should support OP margin improvement (+0.4%p YoY).

Investment points

Poised to become Korea's largest cloud company; rise of generative AI to accelerate industry growth

- Samsung SDS's cloud business consists of: 1) cloud service provider (CSP) services; 2) managed service provider (MSP) services; and 3) software as a service (SaaS). While captive customers account for a large share of revenue (low-90% level), the mix of non-captive customers is gradually increasing, led by the MSP segment.
- Cloud revenue breakdown: 33.6% for CSP services, 49.9% (+12.7%p YoY) for MSP services, and 17.5% (-7.9%p YoY) for SaaS

Cloud business has plenty of momentum

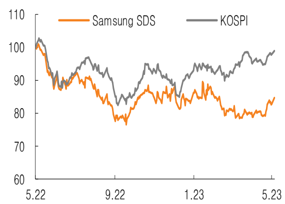
- 1) Cloud adoption by group affiliates to accelerate: Affiliates are likely to step up their cloud usage in pursuit of cost savings and scalability (AI, big data analytics, etc.).
- 2) Opening of the Dongtan data center: The company's Dongtan data center is dedicated to high-performance computing (HPC) and is expected to see annual revenue of over W100bn.
- 3) Rising competitiveness in MSP and SaaS: The Emro acquisition should boost synergies in supply chain management.

Valuation and recommendation

Initiate coverage with Buy and TP of W185,000

- We derived our target price by applying a P/E of 20x, the stock's multiple in 2019 (the year before the pandemic), to our 2024 EPS estimate. We expect temporary revenue fluctuations related to the pandemic to finally end in 2024.
- However, we believe growth rates could remain affected by tough comparisons through 3Q23. Accordingly, the stock is our second favorite pick in the software sector.

Key data



Current price (5/30/23, W)	124,900	Market cap (Wbn)	9,664
OP (22F, Wbn)	823	Shares outstanding (mn)	77
Consensus OP (23F, Wbn)	872	Free float (%)	48.9
EPS growth (23F, %)	-28.9	Foreign ownership (%)	16.0
P/E (23F, x)	12.4	Beta (12M)	0.64
Market P/E (23F, x)	16.4	52-week low (W)	113,000
KOSPI	2,585.52	52-week high (W)	149,000

Share performance

(%)	1M	6M	12M
Absolute	6.5	-2.0	-16.2
Relative	3.0	-6.3	-13.4

Earnings and valuation metrics

(Dec.)	2019	2020	2021	2022	2023F	2024F
Revenue (Wbn)	10,720	11,017	13,630	17,235	14,337	15,348
OP (Wbn)	990	872	808	916	823	849
OP margin (%)	9.2	7.9	5.9	5.3	5.7	5.5
NP (Wbn)	736	443	611	1,100	782	786
EPS (W)	9,518	5,731	7,899	14,213	10,110	10,161
ROE (%)	11.8	6.7	8.8	14.2	9.2	8.6
P/E (x)	20.4	31.1	19.8	8.7	12.4	12.3
P/B (x)	2.3	2.1	1.7	1.2	1.1	1.0
Div. yield (%)	1.2	1.3	1.5	2.6	2.6	2.6

Notes: Under consolidated K-IFRS; NP is attributable to owners of the parent
Source: Company data, Mirae Asset Securities Research estimates

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I. Earnings and valuation

1. Earnings review and outlook

1Q23 review

For 1Q23, Samsung SDS reported revenue of W3.4tr (-18.9% YoY, -20% QoQ) and operating profit of W194bn (-29% YoY, +3.6% QoQ; OP margin of 5.7%).

Overall revenue was dragged down by the logistics division, which was affected by a tough comparison (with rates stabilizing downward after surging during the pandemic). The division's revenue fell 29.5% YoY to W1.93tr, accounting for 56.8% (-7.5%p QoQ) of total revenue. The division posted an OP margin of 2.5% (+0.4%p QoQ).

The IT services division posted revenue of W1.47tr (+1.2% YoY) and an OP margin of 10%. Revenue from the system integration (SI) and IT outsourcing (ITO) businesses declined, as downstream industries scaled back IT spending amid mounting recession worries. In particular, SI revenue slumped 30% YoY to W287bn on a tough comparison stemming from a sharp rise in IT spending in 1H22 (driven by the resumption of projects previously delayed by the pandemic). Still, we find it positive that the company is responding to economic headwinds by focusing on cost management. This year, we expect labor costs to increase only modestly (low-single-digit level vs. 9% in 2021 and 8% in 2022), driving a slight improvement in company-wide OP margin.

The cloud business, the company's new growth driver, recorded revenue of W410bn (+64.6% YoY), accounting for 12.1% (+4%p QoQ) of total revenue. By segment, revenue expanded 5.5% YoY for CSP (31.9% share of cloud revenue), 142.7% YoY for MSP (50.3% share), and 6.8% YoY for SaaS (17.7% share). While the sharp growth in MSP revenue was partly attributable to the reclassification of some ITO sales (around W5bn) to the MSP business, the segment's growth still exceeded 80% when stripping away this factor. We expect the cloud business to contribute meaningfully to earnings going forward, given its relatively high margin.

2023 outlook

For 2023 as a whole, we forecast revenue to decline 16.8% YoY to W14.34tr, hurt by a continued tough comparison for the logistics division. We forecast logistics revenue to fall 30% YoY to W7.86tr, as rates are likely to remain similar to 1Q23 levels.

In contrast, we expect IT services revenue to grow 7.5% YoY to W6.41tr, driven by the cloud business. We forecast cloud revenue to jump 50.4% YoY to W1.75tr. The SI and ITO businesses should also gradually recover from 2H23 after a subdued performance since 2H22.

We conservatively forecast operating profit at W823bn (-10.1% YoY). That said, we expect OP margin to improve 0.4%p YoY to 5.7%, aided by continued cost-saving initiatives and a slowdown in the increase in labor expenses.

Based on our conservative earnings outlook, we expect Samsung SDS to maintain its full-year dividend at the previous year's level (W3,200 per share).

Table 1. Quarterly and annual earnings

(Wbn)	1Q21	2Q21	3Q21	4Q21	1Q22	2Q22	3Q22	4Q22	1Q23	2Q23F	3Q23F	4Q23F	2022	2023F	2024F
Revenue	**3,061**	**3,251**	**3,381**	**3,937**	**4,191**	**4,595**	**4,198**	**4,250**	**3,401**	**3,614**	**3,634**	**3,688**	**17,235**	**14,337**	**15,348**
YoY	25.7%	26.7%	13.9%	29.2%	36.9%	41.4%	24.2%	8.0%	-18.9%	-21.3%	-13.4%	-13.2%	26.4%	-16.8%	7.1%
IT services	**1,368**	**1,392**	**1,379**	**1,498**	**1,452**	**1,511**	**1,487**	**1,518**	**1,470**	**1,598**	**1,674**	**1,739**	**5,968**	**6,413**	**6,998**
YoY	6.4%	5.5%	3.3%	9.0%	6.1%	8.6%	7.8%	1.3%	1.2%	5.8%	12.6%	14.6%	5.9%	7.5%	9.1%
% of revenue	44.7%	42.8%	40.8%	38.0%	34.7%	32.9%	35.4%	35.7%	43.2%	44.2%	46.1%	47.2%	34.6%	44.7%	45.6%
Gross margin	14.0%	13.6%	12.8%	9.7%	11.7%	11.3%	10.7%	10.5%	12.9%	12.1%	12.0%	11.9%	0.0%	0.0%	0.0%
SI revenue	414.7	401.5	382.4	442.7	410.0	408.3	351.6	314.0	287.0	362.0	379.7	393.9	1,484	1,423	1,674
YoY	29.9%	18.0%	7.5%	24.0%	-1.1%	1.7%	-8.0%	-29.1%	-30.0%	-11.3%	8.0%	25.4%	-9.6%	-4.1%	17.7%
% of revenue	13.5%	12.3%	11.3%	11.2%	9.8%	8.9%	8.4%	7.4%	8.4%	10.0%	10.4%	10.7%	8.6%	9.9%	10.9%
ITO revenue	739.1	776.2	777.2	832.2	793.5	829.9	836.3	862.0	773.0	812.5	848.4	876.1	3,322	3,310	3,425
YoY	-3.6%	-0.5%	-0.2%	1.8%	7.4%	6.9%	7.6%	3.6%	-2.6%	-2.1%	1.4%	1.6%	6.3%	-0.4%	3.5%
% of revenue	24.1%	23.9%	23.0%	21.1%	18.9%	18.1%	19.9%	20.3%	22.7%	22.5%	23.3%	23.8%	19.3%	23.1%	22.3%
Cloud revenue	214.6	214.2	219.6	222.9	249.0	272.7	299.2	341.8	409.9	423.4	445.8	469.3	1,163	1,748	2,175
YoY					16.0%	27.3%	36.2%	53.3%	64.6%	55.3%	49.0%	37.3%	33.4%	50.4%	24.4%
% of revenue	7.0%	6.6%	6.5%	5.7%	5.9%	5.9%	7.1%	8.0%	12.1%	11.7%	12.3%	12.7%	6.7%	12.2%	14.2%
CSP revenue					95.9	101.8	113.4	124.1	130.9	143.0	156.4	158.1	435.2	588.3	716.9
YoY									36.5%	40.4%	37.9%	27.4%		35.2%	21.9%
% of cloud revenue					38.5%	37.3%	37.9%	36.3%	31.9%	33.8%	35.1%	33.7%	37.4%	33.6%	33.0%
MSP revenue					85.0	92.2	111.6	143.5	206.3	201.5	208.6	228.8	432	845	1,091
YoY									142.7%	118.5%	86.9%	59.5%		95.5%	29.0%
% of cloud revenue					34.1%	33.8%	37.3%	42.0%	50.3%	47.6%	46.8%	48.8%	37.2%	48.3%	50.1%
SaaS revenue					68.1	78.7	74.2	74.2	72.7	79.0	80.9	82.4	295.2	314.9	367.5
YoY									6.8%	0.4%	9.0%	11.0%		6.7%	16.7%
% of cloud revenue					27.4%	28.9%	24.8%	21.7%	17.7%	18.7%	18.1%	17.6%	25.4%	18.0%	16.9%
Logistics	**1,693**	**1,859**	**2,002**	**2,439**	**2,739**	**3,084**	**2,711**	**2,732**	**1,931**	**2,016**	**1,960**	**1,949**	**11,267**	**7,856**	**8,074**
YoY	47.2%	49.1%	22.6%	45.8%	61.8%	65.9%	35.4%	12.0%	-29.5%	-34.6%	-27.7%	-28.7%	41.0%	-30.3%	2.8%
% of revenue	55.3%	57.2%	59.2%	62.0%	65.3%	67.1%	64.6%	64.3%	56.8%	55.8%	53.9%	52.8%	65.4%	54.8%	52.6%
SG&A expenses	212	216	209	238	217	248	262	257	246	231	228	225	984	930	984
OP	**217**	**225**	**222**	**144**	**274**	**270**	**185**	**188**	**194**	**205**	**209**	**215**	**916**	**823**	**849**
OP margin	7.1%	6.9%	6.6%	3.7%	6.5%	5.9%	4.4%	4.4%	5.7%	5.7%	5.8%	5.8%	5.3%	5.7%	5.5%
EPS (W)	**2,016**	**2,057**	**2,489**	**1,336**	**2,553**	**3,453**	**5,055**	**3,151**	**2,618**	**2,569**	**3,626**	**2,085**	**14,213**	**9,211**	**9,254**
YoY		10.4%	22.4%	-39.8%	26.6%	67.9%	103.1%	135.9%	2.5%	-25.6%	-28.3%	-33.8%	79.9%	-35.1%	0.0%

Source: Company data, Mirae Asset Securities Research estimates

2. Valuation and recommendation

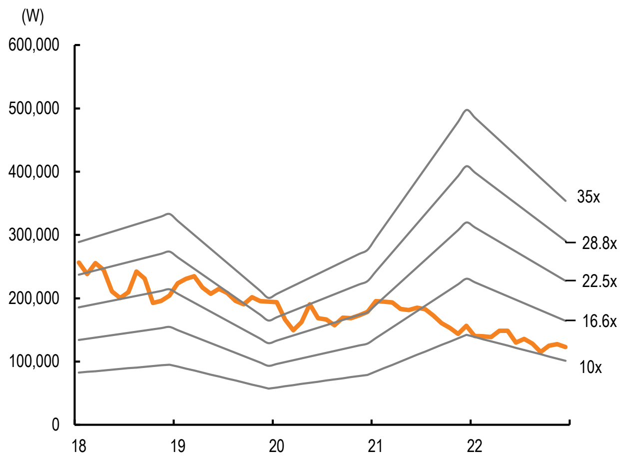
We initiate our coverage of Samsung SDS with a Buy rating and target price of W185,000. We derived our target price by applying a P/E of 10x—the stock's multiple in 2019, the year before the pandemic—to our 2024 EPS estimate. We expect temporary revenue fluctuations related to the pandemic to finally end in 2024. While economic headwinds and downstream weakness could continue to weigh on top-line growth in the near term, we think margins will improve on the back of: 1) the robust growth of the high-margin cloud business; 2) a gradual recovery in IT spending in 2H23; and 3) ongoing cost reductions. Still, we caution that growth rates could remain affected by tough comparisons through 3Q23.

Table 2. Valuation

		Notes
2024F EPS (W)	9,254	
No. of shares (mn)	77	
Target P/E (x)	20x	Multiple in 2019, the year before the pandemic
TP (W)	185,000	
CP (W)	124,900	As of May 30
Upside	48.1%	

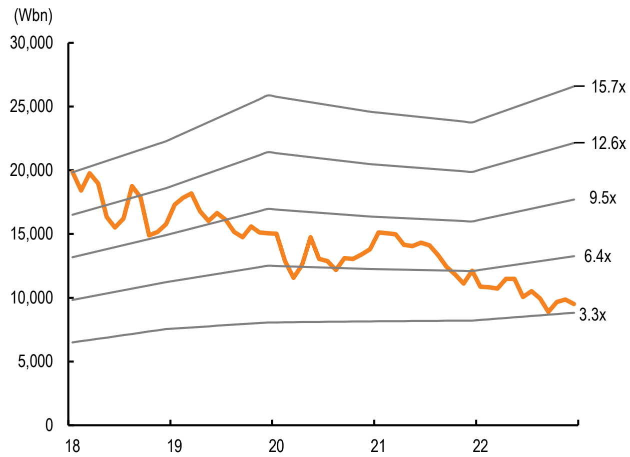
Source: Mirae Asset Securities Research estimates

Figure 1. P/E band chart



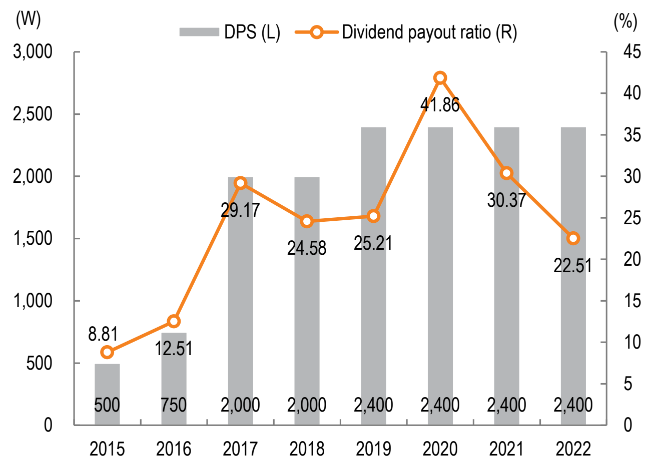
Source: FnGuide, Mirae Asset Securities Research

Figure 2. EV/EBITDA band chart



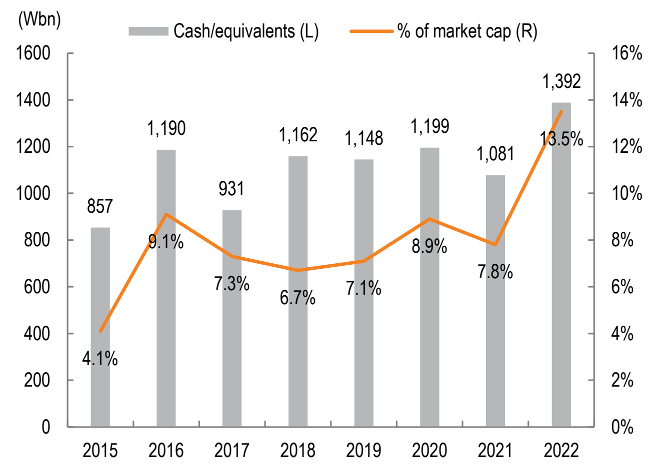
Source: FnGuide, Mirae Asset Securities Research

Figure 3. DPS and dividend payout ratio



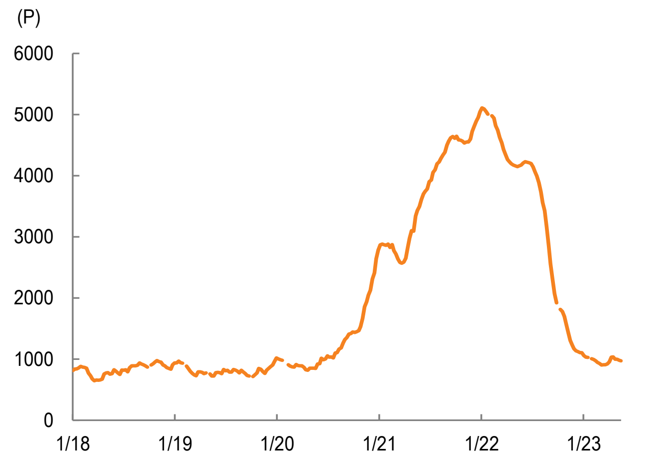
Source: Company data, Mirae Asset Securities Research

Figure 4. Cash and cash equivalents



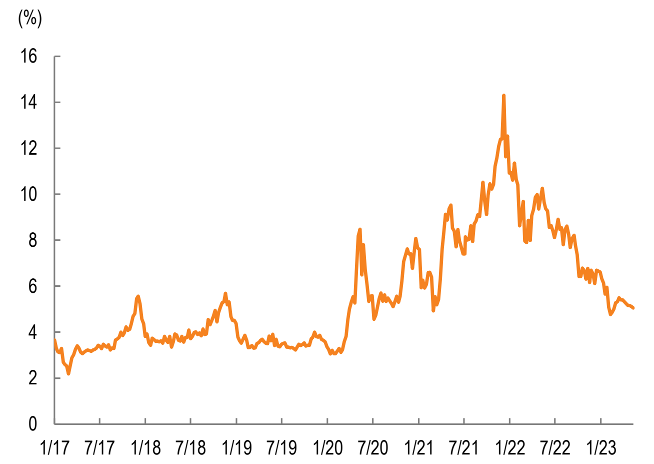
Source: QuantiWise, Mirae Asset Securities Research

Figure 5. SCFI trend



Source: FactSet, Mirae Asset Securities Research

Figure 6. TAC Index trend



Source: Refinitiv, Mirae Asset Securities Research

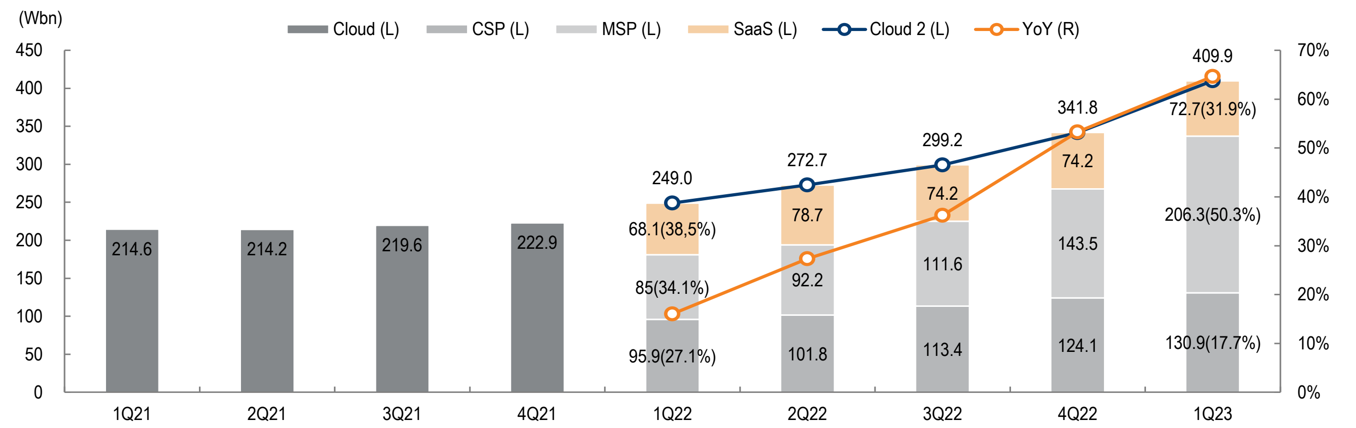
II. Investment points

1. Poised to become Korea's largest cloud company; rise of generative AI to accelerate industry growth

This year, Samsung SDS has begun to separately disclose the earnings of the cloud business, which it sees as its next growth driver. Over 90% of cloud revenue comes from captive customers. Because the company only recently launched CSP services, non-captive revenue exposure is still relatively low in the CSP and SaaS segments (less than 10% vs. mid-10% level for MSP). Nevertheless, we believe the firm will have an easier time luring non-captive customers with its CSP services (compared with its past IDC services). At the same time, captive demand should grow amid accelerating cloud adoption by group affiliates. For 2023, we forecast cloud revenue to expand 50.4% YoY to W1.75tr, with 33.6% (-3.8%p YoY) coming from CSP, 49.9% (+12.7%p YoY) from MSP, and 17.5% (-7.9%p YoY) from SaaS.

We estimate the global public cloud market will grow 18.4% YoY to US$558bn in 2023. Cloud adoption has surged globally in recent years, with cloud penetration in the US already surpassing 80%. Meanwhile, we estimate Korea's public cloud market will grow 15.4% YoY (slightly lagging global market growth) to W2.6tr in 2023. We believe the Korean market offers ample opportunities to cloud service providers and believe Samsung SDS is well-positioned to secure a lead in the market, supported by economies of scale and network effects.

Figure 7. Samsung SDS's cloud revenue breakdown



Source: Company data, Mirae Asset Securities Research

Table 3. Cloud business overview

Segment	Service details	Margins	Competitors
CSP (cloud service provider)	- Equip data centers with hardware and provide customers with infrastructure (servers, networking, storage, etc.) - Serve as a one-stop shop for diverse cloud-based services, from platforms (development tools, database, etc.) to software (applications, services, etc.)	Medium	Global: Amazon AWS, Microsoft Azure, Google Cloud, Oracle Cloud, Alibaba Cloud, etc. Korea: KT Cloud, NAVER Cloud, NHN Cloud
MSP (managed service provider)	- Manage all of the technology needs associated with CSP services, from IT systems to infrastructure management, monitoring, and data backup - Remotely manage cloud assets for customers without internal expertise, offering convenience and reducing risks associated with IT operation	Low	Global: IBM, Accenture, CISCO, etc. Korea: Bespin Global, Megazone Cloud, SK C&C, LG CNS, etc.
SaaS (software as a service)	- Serviced on the cloud and accessible through web browsers; distinct from software as a product (SaaP), which requires a license purchase and app installation - Offers scalability and flexibility and can contribute to the growth of recurring revenue	High	Global: Microsoft, Adobe, Salesforce, ServiceNow, Intuit (top five SaaS companies by market cap) Korea: Kakao Enterprise, Douzone Bizon, Emro

Source: Mirae Asset Securities Research

Table 4. Major cloud companies in Korea

	Cloud revenue (2022)	Cloud revenue growth	% of total revenue	Notes
NHN Cloud	W308.7bn	41%	35.26%	Spun off in Apr. 2022; offers MSP, CSP, and B2B solutions
KT Cloud	W523.6bn	15%	2%	Spun off in Apr. 2022; offers IDC and CSP services
NAVER	W402.9bn	5.3%	4.90%	NAVER Cloud Platform (NCP), Works Mobile, Clova
Samsung SDS	W1.16tr	33.40%	6.70%	Ongoing integration of CSP, MSP, and SaaS businesses

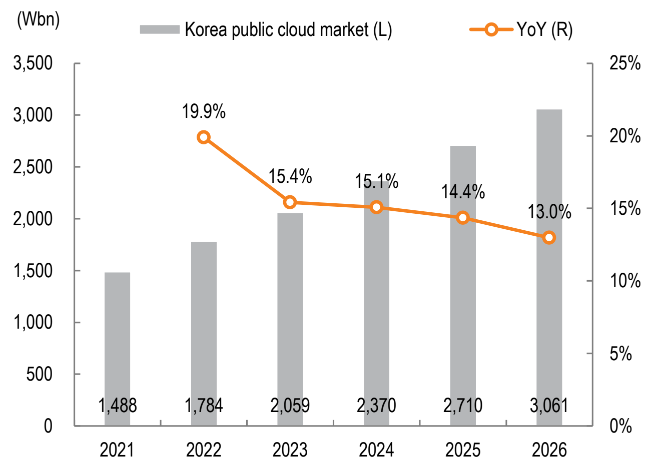
Note: For NHN Cloud and KT Cloud, % of total revenue is based on pre-spin-off data.
Source: Company data, Mirae Asset Securities Research

Table 5. Global public cloud service industry: Size and forecast

(US$mn)	2020	2021	2022	2023F	2024F	2025F	2026F
PaaS	57,432	78,243	95,387	115,527	142,520	172,663	207,553
SaaS	120,910	146,326	165,720	190,086	226,336	266,034	308,652
BPaaS	46,079	54,942	59,695	63,805	70,214	76,385	82,612
DaaS	1,242	2,059	2,515	3,004	3,455	3,805	4,183
Management/security	23,356	28,489	33,863	40,645	50,306	60,925	72,497
IaaS	64,286	90,894	114,394	145,089	192,139	244,051	298,796
Total	313,306	400,954	471,574	558,156	684,970	823,863	974,293
YoY							
PaaS		36.2%	21.9%	21.1%	23.4%	21.1%	20.2%
SaaS		21.0%	13.3%	14.7%	19.1%	17.5%	16.0%
BPaaS		19.2%	8.7%	6.9%	10.0%	8.8%	8.2%
DaaS		65.8%	22.2%	19.4%	15.0%	10.1%	9.9%
Management/security		22.0%	18.9%	20.0%	23.8%	21.1%	19.0%
IaaS		41.4%	25.9%	26.8%	32.4%	27.0%	22.4%
Total		28.0%	17.6%	18.4%	22.7%	20.3%	18.3%

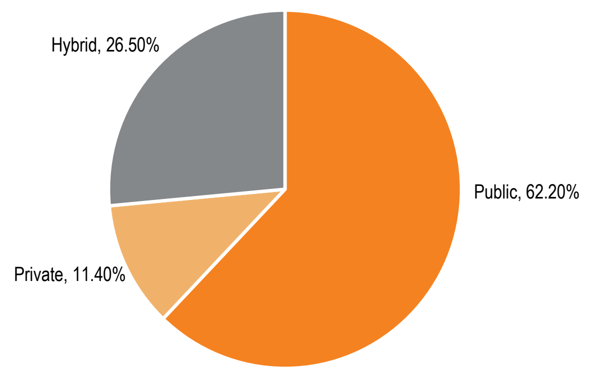
Source: Gartner (Dec. 2022), Mirae Asset Securities Research

Figure 8. Korean public cloud market outlook



Source: IDC, Mirae Asset Securities Research

Figure 9. Cloud market breakdown



Source: Korea Fair Trade Commission (2022), Mirae Asset Securities Research

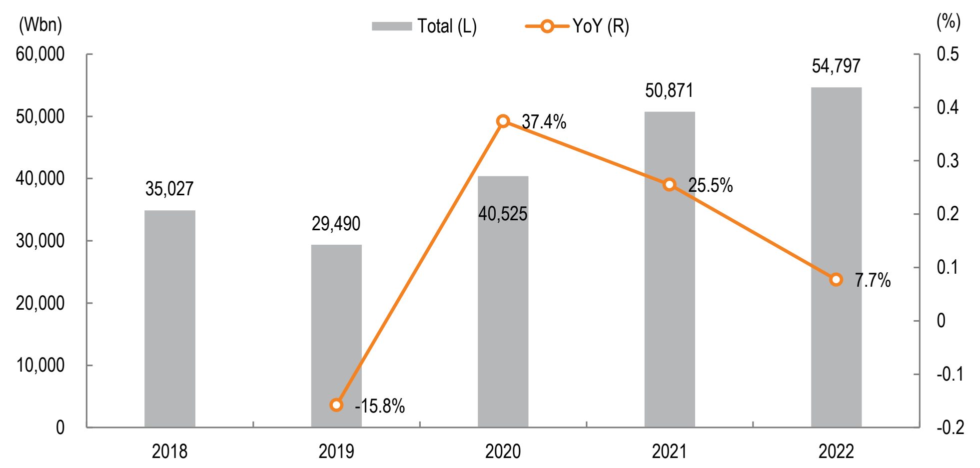
2. Three momentum drivers for the cloud business

In 1Q23, even as revenue from the SI and ITO businesses declined 30% and 2.6% YoY, respectively (hurt by reduced IT spending amid concerns over the economy as well as a high base of comparison), Samsung SDS's cloud revenue surged 64.6% YoY. We highlight three drivers behind the strong growth of the cloud business: 1) rising cloud adoption by group affiliates; 2) the opening of the Dongtan data center (expected to see annual revenue of over W100bn); and 3) the strong competitiveness of the MSP and SaaS businesses.

1) Cloud adoption by group affiliates to accelerate

Since last year, Samsung SDS has been investing aggressively in Samsung Cloud Platform (SCP) in an effort to grow the cloud business. Previously, the company assigned dedicated servers to individual customers, and only some servers offered cloud computing capabilities. However, more and more group affiliates are migrating to the public cloud, which offers advantages such as: 1) lower costs (as cloud server resources are shared with other tenants); 2) access to cutting-edge technologies such as AI and big data; and 3) greater flexibility in meeting security and compliance requirements. For Samsung SDS, increasing cloud adoption means the commencement of subscription (i.e., recurring) sales, which should support earnings stability.

Figure 10. Capex spending by group affiliates



Note: Based on 10 affiliates: Samsung F&M, Samsung Card, Samsung Securities, Samsung Heavy Industries, Samsung Electronics, Samsung Electro-Mechanics, Samsung Engineering, Samsung Life Insurance, Samsung C&T, and Samsung SDI
Source: QuantiWise, Mirae Asset Securities Research

2) Dongtan data center

Opened in Jan. 2023, Samsung SDS's new facility in Dongtan is Korea's first HPC data center, specializing in resource-intensive tasks such as semiconductor design, generative AI, and supercomputing. Compared with general-purpose data centers, HPC data centers have a higher density of servers (connected using high-bandwidth network technologies), more powerful processors, and more significant storage and cooling requirements. Highlighting such centers' need for advanced infrastructure, the average power consumption of a rack is in the 15-20kW range for an HPC server vs. 5kW for a general-purpose server.

Currently, group affiliates are using the facility to carry out computer-aided design (CAD) and computer-aided engineering (CAE) for chip design and process simulation.

The Dongtan data center opened with 15,000 servers in its east wing, but the company plans to add more than 10,000 servers in the west wing to enhance the facility's high-capacity cloud computing capabilities, which are required for AI and big data analysis. We expect the Dongtan data center to exhibit annual revenue growth of over 50%.

Figure 11. Dongtan data center (opened in Jan. 2023)

Source: Company materials, Mirae Asset Securities Research

Figure 12. HPC data center characteristics

Overview	- Designed to support HPC systems specializing in resource-intensive tasks such as massive data processing and complex modeling/simulation - Higher infrastructure requirement; more demanding and costly to operate
Characteristics	
HPC resources	- To carry out large-scale, parallel processing, HPC data centers need specialized hardware, multi-core processors, and high-speed networks - GPU servers can be built on HCP
Large-capacity data storage/ management	- Large-scale data storage and efficient data management are critical
High-speed network infrastructure	- Infrastructure needed to support the high-speed transmission of massive data and distributed processing
Supercomputers and GPUs	- Supercomputers with enormous computing power and GPUs for generative AI

Source: Mirae Asset Securities Research

3) Strong competitiveness in MSP and SaaS

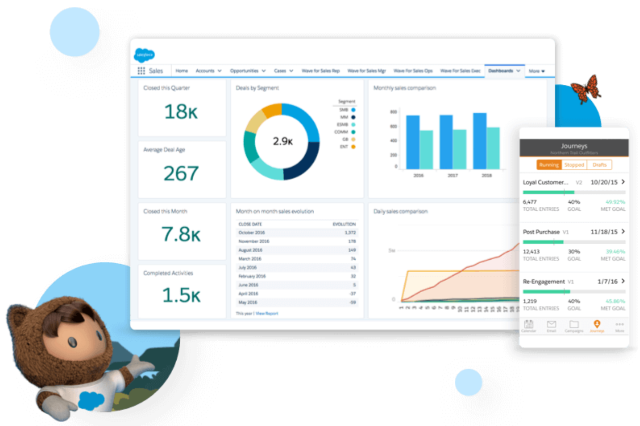
While the MSP and SI businesses may appear similar, the MSP business does more than simply convert legacy systems to the cloud through application modernization; Samsung SDS has also been actively rolling out new features (containers, DevOps, etc.) to drive sales.

Notably, the company is increasingly supplying in-house services/solutions such as Knox Meeting/Portal (collaboration tools) and Brity RPA (business automation tool) in addition to customizing/deploying platforms from global SaaS companies (e.g., Salesforce and Workday).

Samsung SDS continues to expand its portfolio of equity investments in domestic SaaS companies. In March, the company acquired a 33.4% stake in Emro, a supply chain management (SCM) SaaS company, becoming its largest shareholder. Since 2020, Samsung SDS has partnered with o9 Solutions, a leading US-based SCM company, to jointly expand solutions. We think Samsung SDS is well-positioned to combine the strengths of o9 (supply chain planning) and Emro (supply relationship management) with its own digital forwarding platform, Cello Square, to become a one-stop SCM solution provider.

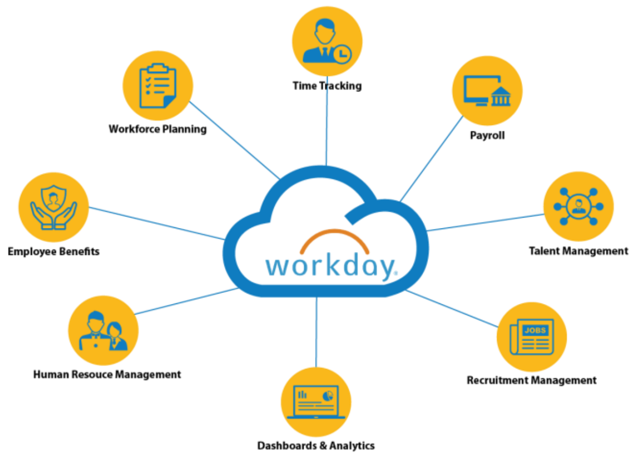
Samsung SDS has also been pushing into the cyber security space by investing in SECUI, a Korea-based network security service provider, and SentinelOne, a US-based cybersecurity company. We think these efforts will help strengthen the company's competitive position at a time when cybersecurity is increasing in importance.

Figure 13. Salesforce's CRM SaaS platform



Source: Salesforce, Mirae Asset Securities Research

Figure 14. Workday is a leader in HRM systems



Source: Workday, Mirae Asset Securities Research

III. Company overview

Founded in 1985, Samsung SDS went public on Nov. 14, 2014. At the time of its IPO, the company's two largest shareholders were Samsung Electronics (SEC), with a 22.58% stake, and Samsung C&T, with 17.08%; these ownership levels have not changed since then.

Samsung SDS went public as the largest ICT company in Korea. Its IPO—which came around the same time as a series of record-setting Nasdaq IPOs by global tech companies like Facebook (2012), Twitter (2013), and Alibaba (2013)—was a success, with the stock opening trading at W380,000, 100% above the offering price of W190,000. Through the IPO, Samsung's controlling family raised the W5tr needed to overhaul the group's governance structure. With the expiration of the lock-up period in May 2015, shares of Samsung SDS surged on expectations for governance and corporate structure improvements. However, expectations for a merger between SEC and Samsung SDS subsequently dissipated. And with Samsung's controlling family maintaining its stake, governance issues have since served as a discount factor.

Figure 15. Samsung SDS's market cap

Source: QuantiWise, Mirae Asset Securities Research

Table 6. Company history

Year	Description
May 1985	Founded as Samsung Data Systems
Dec. 1991	Surpassed annual revenue of W100bn
Jan. 2009	Opened the first cloud computing center in Korea
Jan. 2010	Merged with Samsung Networks
Dec. 2013	Merged with Samsung SNS
Nov. 2014	Listed on the KOSPI
Oct. 2021	Launched cross-border logistics service Cello Square
Mar. 2023	Acquired 33.4% stake in Emro, Korea's leading SCM solution provider, becoming the largest shareholder

Source: Company data, Mirae Asset Securities Research

Table 7. Major shareholders

	Early 2022	End-2022	May 2023
Samsung Electronics	22.58%	22.58%	22.58%
Samsung C&T	17.08%	17.08%	17.08%
Lee Jae-yong	9.20%	9.20%	9.20%
National Pension Service	7.77%	7.77%	7.77%
Lee Boo-jin	3.90%	1.95%	1.95%
Lee Seo-hyun	3.90%	1.95%	0.00%
Samsung Life	0.09%	0.00%	

Source: Dart, Mirae Asset Securities Research

Business overview

Samsung SDS has two business divisions: logistics and IT services. In 1Q23, IT services made up 43.2% of revenue and logistics 56.8%.

The company's IT services are divided into SI, ITO, and cloud. The share of non-captive customers has been gradually rising, reaching 19% in 2022 (vs. 14% in 2018). Key customers include Korean Air (cloud), AmorePacific (cloud), EcoPro BM (smart factory), Mando (enterprise resource planning [ERP]), and Woori Bank (other).

1) The SI business includes ERP and smart factory solutions. The ERP segment manages deployment of S/4HANA—a next-generation ERP software developed by German software firm SAP SE—on an outsourced basis. The smart factory business has been expanding with a focus on manufacturing logistics automation and digital twin technology. The company has built a successful track record by delivering solutions for group affiliates (e.g., Samsung Electronics, Samsung Display, Samsung SDI, and Samsung Electro-Mechanics) and securing about 300 non-affiliated customers.

2) The ITO business includes IT outsourcing, server, network, and HRM solutions.

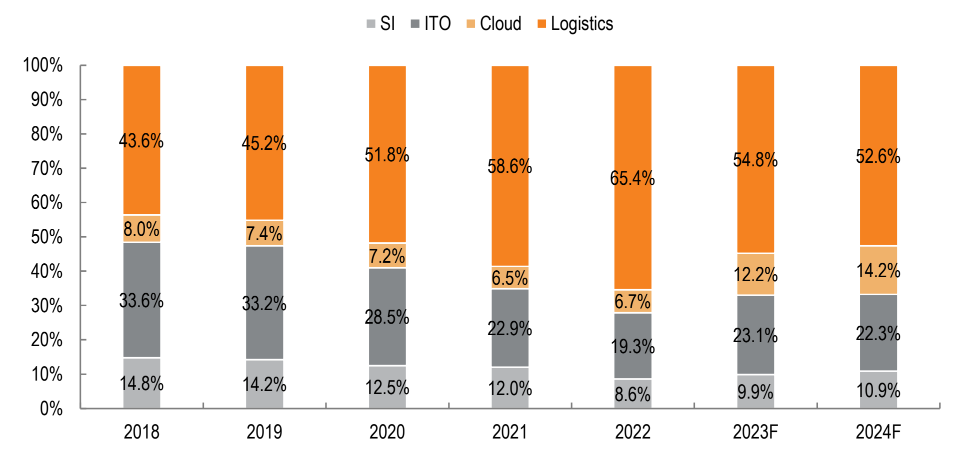
3) The cloud business includes CSP, MSP, and SaaS.

Similar to Amazon and Microsoft, Samsung SDS's CSP business operates data centers and provides servers, storage, and networks on the cloud. The firm recently launched an enterprise cloud platform called SCP and plans to expand its HPC business in 2023 with the opening of the Dongtan data center. As of 1Q23, CSP accounts for 31.9% of cloud revenue, with captive exposure exceeding 90%.

The MSP business manages all of the technology needs associated with CSP services, enabling customers to build, operate, and convert to cloud products. Key domestic competitors include Bespin Global and Megazone Cloud. As of 1Q23, the MSP business accounted for 50.3% of cloud revenue, with captive exposure in the mid-80% range.

The SaaS business provides application solutions based on cloud data centers, removing the need for businesses to build their own servers. SaaS solutions are provided through subscription licensing. Samsung SDS sells its own SaaS solutions, such as Brity RPA (business automation) and EMM (mobile security), and the firm recently invested in supply chain solution provider Emro to expand collaborative solutions. As of 1Q23, the SaaS business accounted for 17.7% of cloud revenue, with captive exposure exceeding 90%.

Figure 16. Revenue by business



Source: Company data, Mirae Asset Securities Research

The logistics division has been a core business of Samsung SDS since its IPO. However, the division has recently faced negative growth due to a high base of comparison (stemming from sharp rate increases during the pandemic).

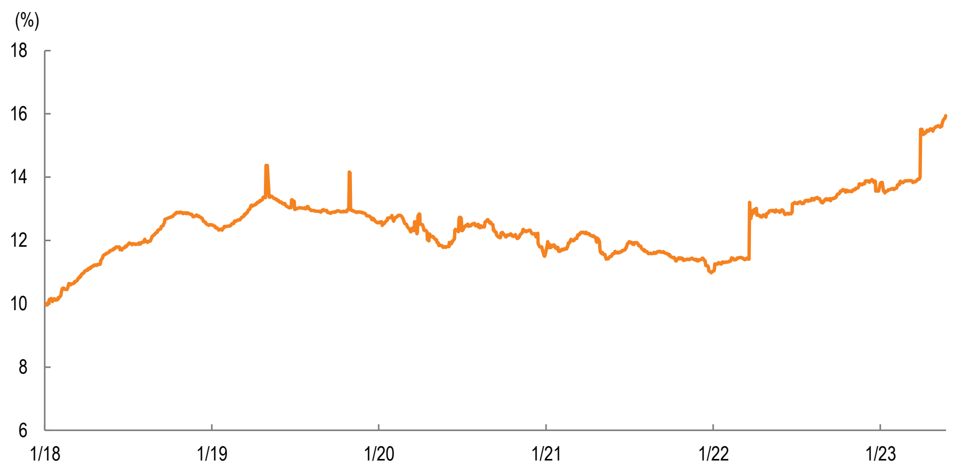
Samsung SDS launched Cello Square, a full-range logistics service platform, in Oct. 2021. Cello Square serves as a one-stop logistics channel, encompassing procurement, supply, sales, and last-mile delivery. Samsung SDS has secured a logistics network comprising 53 bases in 36 countries and is collaborating with 1,900 partners in air, maritime, and inland transportation/warehousing operations. For air freight, Samsung SDS has entered partnerships with 78 air cargo operators, including Korean Air and DHL, to transport mobile phones, semiconductors, and medicines. For maritime freight, the company has signed partnerships with 206 shipping companies such as Maersk and HMM to transport home appliances and solar PV modules. In 2022, air freight/maritime freight represented 48.5% of logistics revenue, with inland shipping/warehousing making up 51.5%. The mix of non-captive customers increased from 13% in 2018 to 17% in 2022. Key customers include HP, Hanon Systems, Hyundai Mobis, Musinsa, and Hanwha Solutions.

Table 8. Peer valuation table

Type	Company	Ticker	FY end	Price (Local)	Market cap (US$mn)	Return (%)				P/E (x)				EV/EBITDA (x)			
						5D	3M	6M	12M	-1FY	0FY	1FY	2FY	-1FY	0FY	1FY	2FY
Domestic SI	Samsung SDS	018260	Dec.	124,900	2,585.2	-2.3	9.8	12.3	-6.9	51.1	23.0	25.4	22.2	17.7	8.0	9.0	8.0
	Hyundai AutoEver	307950	Dec.	123,700	7,270.9	1.2	-0.8	-2.5	-16.3	19.8	8.7	14.0	12.8	6.6	3.9	3.5	2.9
	Lotte Data Comm.	286940	Dec.	28,050	331.7	0.9	-2.9	22.3	-4.0	15.8	11.7	9.6	8.1	6.2	5.1	3.9	2.8
	POSCO DX	022100	Dec.	11,630	1,311.4	-5.4	67.1	62.5	83.7	-	20.8	32.0	25.0	-	11.9	19.5	15.0
	Shinsegae I&C	035510	Dec.	14,620	191.8	-0.2	-7.2	2.4	-9.8	7.7	2.2	-	-	3.9	1.2	-	-
Global cloud	Microsoft	MSFT US	Jun.	2.5	123.4	10.8	-43.2	-48.0	-67.9	5.0	4.6	11.6	5.7	3.7	6.6	2.7	2.1
	Oracle	ORCL US	May	15.9	65,983.0	1.6	-11.4	-21.9	-15.7	-	-	20.1	18.9	-	-	13.6	12.2
	IBM	IBM US	Dec.	91.2	24,678.3	-3.4	-21.5	-14.5	-14.1	66.3	34.8	21.4	15.3	21.9	13.2	10.8	8.6
Global SaaS	Salesforce	CRM US	Jan.	215.4	215,440.0	2.4	31.7	34.4	30.5	467.3	154.2	30.1	24.4	47.5	25.9	18.0	15.3
	ServiceNow	NOW US	Jan.	537.5	109,502.2	5.3	24.4	29.1	12.8	535.9	229.0	56.5	45.7	151.2	83.0	37.5	28.4
	Intuit	INTU US	Jul.	418.4	117,185.4	-6.2	2.8	2.7	-1.0	70.1	62.2	29.4	26.0	50.1	38.2	21.0	18.6
	Workday	WDAY US	Jan.	216.1	56,394.3	10.4	16.5	28.7	36.1	423.0	-	40.8	33.9	130.7	182.1	26.0	20.8

Note: As of May 30, 2023
Source: Bloomberg, Mirae Asset Securities Research

Figure 17. Foreign ownership



Source: QuantiWise, Mirae Asset Securities Research

Samsung SDS (018260 KS)

Income statement (summarized)

(Wbn)	2021	2022	2023F	2024F
Revenue	**13,630**	**17,235**	**14,337**	**15,348**
Cost of revenue	**11,947**	**15,334**	**12,584**	**13,515**
GP	**1,683**	**1,901**	**1,753**	**1,833**
SG&A expenses	**875**	**984**	**930**	**984**
OP (adj.)	**808**	**916**	**823**	**849**
OP	**808**	**916**	**823**	**849**
Non-operating profit	**50**	**216**	**212**	**176**
Net financial income	43	82	160	176
Net income from associates	6	7	2	0
Pretax profit	858	1,132	1,035	1,025
Income tax	224	2	230	216
Profit from continuing operations	633	1,130	805	809
Profit from discontinued operations	0	0	0	0
NP	**633**	**1,130**	**805**	**809**
Attributable to owners	611	1,100	782	786
Attributable to minority interests	22	30	22	23
Total comprehensive income	**773**	**1,212**	**902**	**809**
Attributable to owners	745	1,180	881	790
Attributable to minority interests	28	31	21	19
EBITDA	1,250	1,428	1,029	934
FCF	694	698	-3,093	-4,507
EBITDA margin (%)	9.2	8.3	7.2	6.1
OP margin (%)	5.9	5.3	5.7	5.5
Net margin (%)	4.5	6.4	5.5	5.1

Balance sheet (summarized)

(Wbn)	2021	2022	2023F	2024F
Current assets	**7,576**	**8,006**	**7,715**	**8,567**
Cash & equivalents	1,081	1,392	1,975	2,283
AR & other receivables	2,609	2,551	2,213	2,424
Inventory	44	41	35	39
Other current assets	3,842	4,022	3,492	3,821
Non-current assets	**2,941**	**3,947**	**4,567**	**4,492**
Investments in associates	110	119	103	113
PP&E	1,179	1,520	1,619	1,557
Intangible assets	715	713	1,260	1,237
Total assets	**10,517**	**11,952**	**12,282**	**13,059**
Current liabilities	**2,370**	**2,493**	**2,203**	**2,393**
AP & other payables	892	797	692	758
Short-term financial liabilities	149	193	207	207
Other current liabilities	1,329	1,503	1,304	1,428
Non-current liabilities	**703**	**992**	**961**	**987**
Long-term financial liabilities	313	676	687	687
Other non-current liabilities	390	316	274	300
Total liabilities	**3,074**	**3,485**	**3,164**	**3,380**
Equity attributable to owners	**7,229**	**8,223**	**8,854**	**9,392**
Capital stock	39	39	39	39
Capital surplus	1,297	1,297	1,297	1,297
Retained earnings	6,087	7,001	7,536	8,074
Minority interests	**215**	**244**	**264**	**287**
Shareholders' equity	**7,444**	**8,467**	**9,118**	**9,679**

Cash flow statement (summarized)

(Wbn)	2021	2022	2023F	2024F
Operating cash flow	**980**	**1,290**	**862**	**864**
NP	633	1,130	805	809
Non-cash income/expenses	757	464	290	124
Depreciation	387	462	178	62
Amortization	55	51	27	23
Other	315	-49	85	39
Chg. in working capital	-266	-100	-356	-30
Chg. in AR & other receivables	-377	107	171	-136
Chg. in inventory	0	0	1	-3
Chg. in AP & other payables	241	-49	-124	56
Income tax	-189	-272	-155	-216
Cash flow from investing activities	**-827**	**-645**	**-3,427**	**-5,671**
Chg. in PP&E	-286	-587	-3,951	-5,372
Chg. in intangible assets	-33	-60	-5	0
Chg. in financial assets	-515	-127	481	-300
Other	7	129	48	1
Cash flow from financing activities	**-323**	**-355**	**-49**	**-248**
Chg. in financial liabilities	96	407	25	0
Chg. in equity	0	0	0	0
Dividends	-188	-188	0	-248
Other	-231	-574	-74	0
Chg. in cash	**-118**	**311**	**583**	**307**
Beginning balance	1,199	1,081	1,392	1,975
Ending balance	1,081	1,392	1,975	2,283

Key valuation metrics/ratios

	2021	2022	2023F	2024F
P/E (x)	19.8	8.7	12.4	12.3
P/CF (x)	8.7	6.0	8.8	10.4
P/B (x)	1.7	1.2	1.1	1.0
EV/EBITDA (x)	6.6	3.9	5.5	5.5
EPS (W)	7,899	14,213	10,110	10,161
CFPS (W)	17,975	20,600	14,145	12,050
BPS (W)	93,442	106,294	114,422	121,384
DPS (W)	2,400	3,200	3,200	3,200
Dividend payout ratio (%)	29.3	21.9	30.8	30.6
Dividend yield (%)	1.5	2.6	2.6	2.6
Revenue growth (%)	23.7	26.4	-16.8	7.1
EBITDA growth (%)	-5.5	14.2	-28.0	-9.2
OP growth (%)	-7.3	13.4	-10.1	3.0
EPS growth (%)	37.8	79.9	-28.9	0.5
AR turnover (x)	8.0	9.7	9.3	10.2
Inventory turnover (x)	389.2	404.6	375.4	412.9
AP turnover (x)	17.1	20.5	19.9	22.0
ROA (%)	6.4	10.1	6.6	6.4
ROE (%)	8.8	14.2	9.2	8.6
ROIC (%)	17.7	23.1	13.1	13.8
Debt-to-equity ratio (%)	41.3	41.2	34.7	34.9
Current ratio (%)	319.6	321.1	350.2	358.0
Net debt-to-equity ratio (%)	-55.5	-49.1	-46.5	-50.1
Interest coverage ratio (x)	45.8	31.8	39.2	40.2

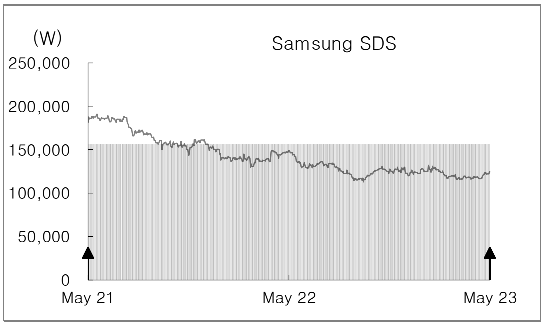
Source: Company Data, Mirae Asset Securities Research estimates

Appendix 1

Important disclosures and disclaimers

Two-year rating and TP history

Company	Date	Rating	TP (W)
Samsung SDS (018260)	05/31/23	Buy	185,000
	03/22/21	No Coverage	



Stock ratings	
Buy	Expected 12-month performance: +20% or greater
Trading Buy	Expected 12-month performance: +10% to +20%
Hold	Expected 12-month performance: -10% to +10%
Sell	Expected 12-month performance: -10% or worse

Sector ratings	
Overweight	Expected to outperform the market over 12 months
Neutral	Expected to perform in line with the market over 12 months
Underweight	Expected to underperform the market over 12 months

Rating and TP history: Share price (─), TP (▬), Not Rated (■), Buy (▲), Trading Buy (■), Hold (●), Sell (♦)
* Our investment rating is a guide to the expected return of the stock over the next 12 months.
* Outside of the official ratings of Mirae Asset Securities Co., Ltd., analysts may call trading opportunities should technical or short-term material developments arise.
* The TP was determined by the research analyst through valuation methods discussed in this report, in part based on estimates of future earnings.
* TP achievement may be impeded by risks related to the subject securities and companies, as well as general market and economic conditions.

Ratings distribution and investment banking services

	Buy	Trading Buy	Hold	Sell
Ratings distribution	85.7%	10.7%	2.9%	0.7%
Investment banking services	87.5%	12.5%	0%	0%

* Based on recommendations in the last 12-months (as of March 31, 2023)

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