

SK Innovation

(096770 KS)

Comment on rights issue: Final stage of growing pains

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- In our view, the size of SK Innovation's latest rights issue is not significant enough to have a material impact. We continue to believe the company will see rapid earnings growth over the medium/long term.
- While the rights issue will dilute shares by roughly 8.1%, this should be partially offset by debt repayment and pre-IPO funds (SK On).
- The company stated that the purpose of the rights issue is to pursue new businesses, mainly low-carbon technology and carbon capture, utilization, and storage (CCUS).

1. Rights issue summary

1) Size: W1.18tr

- SK Innovation will issue 8.19mn new shares, implying 8.1% dilution of current shares outstanding.
- The dilution is largely in line with the drop in shares in the wake of the announcement (-7.5% as of Jun. 26, 12:00 PM).
- According to the regulatory filing, the company plans to use the proceeds on: 1) facility investments (W418.5bn); 2) debt repayment (W350bn); and 3) the purchase of stakes in other companies (W409.2bn).
- The issue price is expected to be W143,800 and will be confirmed on Sep. 6.
- After allocation to existing shareholders, any unsubscribed shares will be offered to the public. The subscription period for existing shareholders will run from Sep. 11 to 12, and the new shares will be listed on Oct. 4.

2) Purpose: Expansion into new businesses

- The company stated that the purpose of the rights issue is to: 1) secure technology and develop businesses related to the supply of carbon-free energy (hydrogen and ammonia); 2) invest in the commercialization of low-carbon aviation fuel through the gasification of landfill waste; and 3) secure technology and develop businesses related to carbon capture and storage for industries where carbon emissions are unavoidable.
- Facility investments (W418.5bn): Build a green campus in Bucheon Daejang to strengthen R&D capabilities
- Debt repayment (W350bn): Redeem commercial paper and corporate bonds
- Purchase of stakes in other companies (W409.2bn): Invest in hydrogen/ammonia (W92.4bn), waste-to-energy (W224.4bn), and CCUS and other businesses

Earnings and valuation metrics

FY (Dec.)	2020	2021	2022	2023F	2024F	2025F
Revenue (Wbn)	34,550	46,853	78,057	72,405	75,706	79,481
OP (Wbn)	-2,420	1,742	3,917	3,503	6,574	8,919
OP margin (%)	-7.0	3.7	5.0	4.8	8.7	11.2
NP (Wbn)	-2,173	292	1,569	2,207	4,470	6,283
EPS (W)	-23,185	3,117	16,743	23,545	47,699	67,047
ROE (%)	-13.6	1.8	8.5	10.6	18.8	21.8
P/E (x)	-	76.5	9.2	7.8	3.8	2.7
P/B (x)	1.1	1.2	0.7	0.7	0.6	0.5
Dividend yield (%)	0.0	0.0	0.0	2.7	2.7	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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2. Comments on rights issue

1) Impact of dilution to be partially offset

- The number of new shares to be issued suggests shares will be diluted by 8.1%.
- That said, part of the proceeds will be used to pay down debt or acquire cash assets. In addition, SK On's pre-IPO funding should lead to cash inflow of around W1.7tr.
- From a balance sheet perspective, a reduction in net debt (W15.6tr as of 1Q23) should partially offset the impact of dilution.
- Because the policy loans secured for the joint venture with Ford (BlueOval SK) will be recognized as liabilities, we believe SK Innovation felt the need to preemptively improve its balance sheet.

2) Worries over SK On funding resolved

- SK On has raised around W2.8tr through pre-IPO funding.
- The battery maker faced some funding challenges last year, but has now successfully raised more than its previous target of W2tr on the back of margin improvements and expectations on advanced manufacturing production credit (AMPC) effects.
- SK On has also secured a W2tr loan from Hyundai Motor/Kia Corp., a move that is expected to enhance the stability of the company's fundraising and its ties with partners.
- More than half of the funds needed for BlueOval SK's plant construction will be financed by US government loans. The joint venture has received conditional approval for a US\$9.2bn loan.

3) Actions to enhance shareholder value

- SK Innovation plans to enhance shareholder value by: 1) giving existing shareholders the option to exchange their shares with SK On shares; 2) distributing special dividends through the sale of SK On's existing shares; and 3) canceling treasury shares (all prior to the battery maker's IPO).
- Regarding the timing of SK On's IPO, management has stated that it is unlikely to take place until after 2025. We do not expect any changes to this schedule, as both the company and investors will likely want the battery maker to go public when its value can be maximized.

4) Our take: Last hurdle

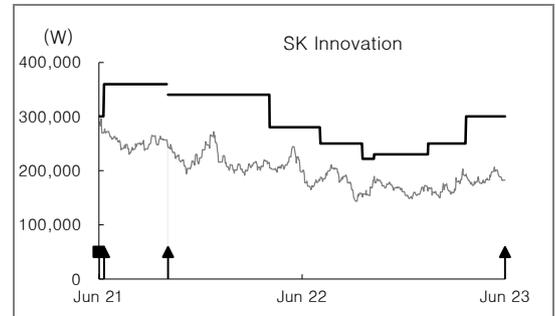
- We believe SK Innovation's earnings are still on track to expand over the medium/long term. We view this rights issue as the final stage of the company's growing pains before it enters a period of full-fledged growth.

Appendix 1

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Two-year rating and TP history

Company	Date	Rating	TP (₩)
SK Innovation (096770)	04/17/23	Buy	300,000
	02/08/23	Buy	250,000
	11/03/22	Buy	230,000
	10/13/22	Buy	222,000
	07/29/22	Buy	250,000
	04/29/22	Buy	280,000
	10/28/21	Buy	340,000
	10/27/21	No Coverage	
	07/05/21	Buy	360,000
	01/08/21	Trading Buy	300,000



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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