

# Easy Bio System

(035810 KQ)

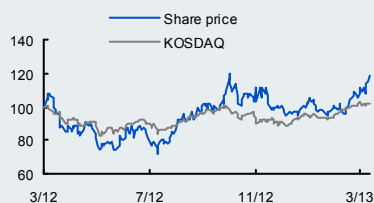
## Attractive valuation and growth drivers

### Pharmaceuticals

Company Report  
March 29, 2013

(Initiate)	<b>Buy</b>
Target Price (12M, W)	<b>9,000</b>
Share Price (03/26/13, W)	3,800
Expected Return	137%

OP (13F, Wbn)	25		
Consensus OP (13F, Wbn)	22		
EPS Growth (13F, %)	20.9		
Market EPS Growth (13F, %)	22.0		
P/E (13F, x)	10.3		
Market P/E (13F, x)	9.2		
KOSDAQ	549.90		
Market Cap (Wbn)	179		
Shares Outstanding (mn)	47		
Free Float (%)	29.6		
Foreign Ownership (%)	1.9		
Beta (12M)	0.90		
52-Week Low (W)	2,305		
52-Week High (W)	3,915		
(%)	1M	6M	12M
Absolute	23.2	20.4	11.9
Relative	24.0	20.3	13.7



Daewoo Securities Co., Ltd.

### Pharmaceuticals

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### Attractive valuation amid exceptional earnings growth

Easy Bio System is a fully integrated biotech company with key business interests in animal feed, feed additives, hog and poultry farming, and, more recently, animal diagnostics and vaccines. The company has achieved integration through active M&A activities, including deals with Dodram B&F (animal feed) in 2003, Maniker (poultry) in 2011, and Samyang Corporation's animal feed business in 2012. Consolidated revenues are comprised of animal feed and additives (47%), meat processing (30%), livestock (17%), and other (6%).

Easy Bio drew market attention in 2011 as pork prices surged following an outbreak of foot-and-mouth disease. Thereafter, its shares have remained stagnant despite attractive valuations, tending to fluctuate alongside the movements of pork, poultry, and grain prices. However, we believe it is time to revisit Easy Bio's investment positives, including: 1) strong earnings expansion on the back of won appreciation, stabilizing grain, pork, and poultry prices, and accelerating overseas growth of the feed additives unit; 2) the expected doubling of revenues at the company's biotech diagnostics subsidiary Optifarm Solution; and 3) the company's undemanding consolidated valuation (2013F P/E of 6x; P/S of 0.1x) owing to solid consolidated interests, which should push up 2013 consolidated net profit by 18% YoY.

### Growth drivers: Increasing exports and potential listing of Optifarm Solution

Easy Bio's feed additive exports (targeting enhanced production yields) started to jump last year, as demand for additives increased along with rising grain prices. Notably, the company has been able to enhance its exports of additives Endonase Plus and Lipidol to US-based grain producer Archer Daniels Midland Company (ADM, NYSE), along with increased exports to Latin America and Asia.

Optifarm Solution is widely considered Korea's leading livestock diagnostic lab, which is enabling the subsidiary to expand its business reach into human diagnostics. Notably, the company has recently developed tissues that are histocompatible with the human body (facilitating organ transplants). Looking ahead, we expect Optifarm Solution to become Easy Bio's major growth driver, with its enterprise value expected to surge along with its planned market listing in 2014.

### Initiate coverage with Buy and a TP of W9,000

We initiate our coverage of Easy Bio System with a Buy rating and a target price of W9,000. Given the hidden value of its subsidiary holdings, we believe the company's fair value is best reflected through a blended average of a P/E valuation (TP: W11,000; based on 20x P/E to 2013F consolidated EPS) and a sum-of-the-parts valuation (TP: W7,000).

FY (Dec.)	12/09	12/10	12/11	12/12P	12/13F	12/14F
Revenue (Wbn)	74	82	95	127	140	163
OP (Wbn)	9	15	13	21	26	31
OP Margin (%)	12.6	17.9	13.9	16.1	18.2	18.7
NP (Wbn)	15	10	5	14	17	22
EPS (W)	366	226	104	307	371	465
ROE (%)	13.3	7.5	3.3	9.2	10.1	11.4
P/E (x)	6.3	8.8	38.7	10.2	10.3	8.2
P/B (x)	0.8	0.6	1.2	0.9	1.0	0.9

Note: All figures are based on non-consolidated K-IFRS;  
Source: Company data, KDB Daewoo Securities Research estimates



### 1. Attractive valuation (P/E of 6x; P/S of 0.1x)

Easy Bio's 2013 consolidated revenue is forecast at W1.63tr, yielding a current P/S ratio (market cap/revenue) of a mere 0.1x. Considering that companies trading at such a low P/S ratio tend to be loss-making, the solid profitability of Easy Bio suggests an extremely attractive valuation for the company. Indeed, this level of leverage suggests that a 1%p improvement in OP margin should lead to earnings growth equivalent to a 10% increase in market cap. Also noteworthy is that, since Easy Bio announced earnings on a non-consolidated basis until end-2012, market watchers have been somewhat misguided on the firm's valuation. However, this misconception should dissipate, as the company will release earnings on a consolidated basis starting this year.

As per Easy Bio's consolidated profit, we expect net profit to improve by 18% YoY to W26.6bn in 2013, as shown in <Table 1>, suggesting a 2013F P/E of 6x. The two key factors driving earnings growth are: 1) the healthy revenue growth of animal feed subsidiaries (13.5% YoY), and 2) diminishing losses at livestock subsidiaries as hog and poultry prices stabilize in 2013. It should be noted that, as hog and chicken prices fell at end-2012, the average cost ratio for livestock climbed from 85.5% in 2011 to 87.3% in 2012. Additionally, we expect Easy Bio to report smaller investment losses related to its subsidiary Maniker (2012 loss of W5bn vs. small gain in 2013).

Table 1. Revenue by business unit

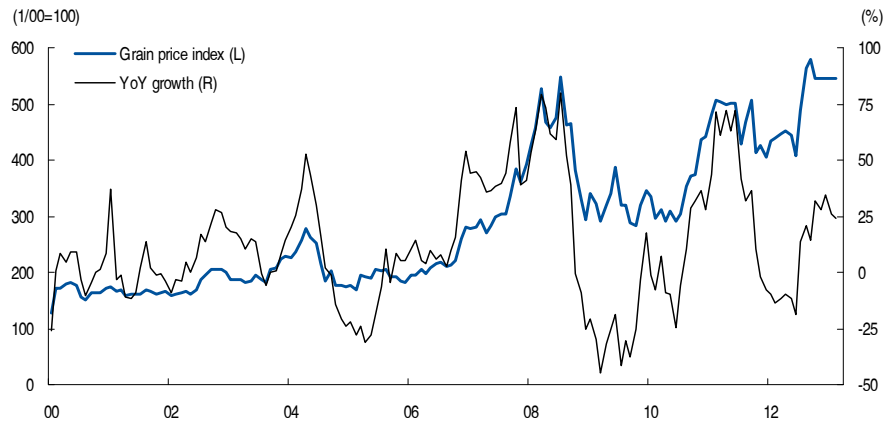
(Wbn)

	Total revenue	Feed division	Livestock division	Poultry division	Others	Internal transactions	Net profit
2010	826.4	582.0	428.8	-	33.3	217.7	18.5
2011	1,070.2	667.1	404.5	225.6	96.4	323.4	7.0
2012P	1,388.7	919.1	340.8	218.2	101.9	191.3	22.6
2013F	1,631.3	1,042.9	382.2	244.2	116.9	154.9	26.6

Notes: All figures are based on consolidated K-IFRS; Acquired Sunghwa Food in 2010, Maniker in 2011 and Easy Pharms in 2012

Source: Company data, KDB Daewoo Securities Research

Figure 2. Grain price index



Source: USDA, KDB Daewoo Securities Research

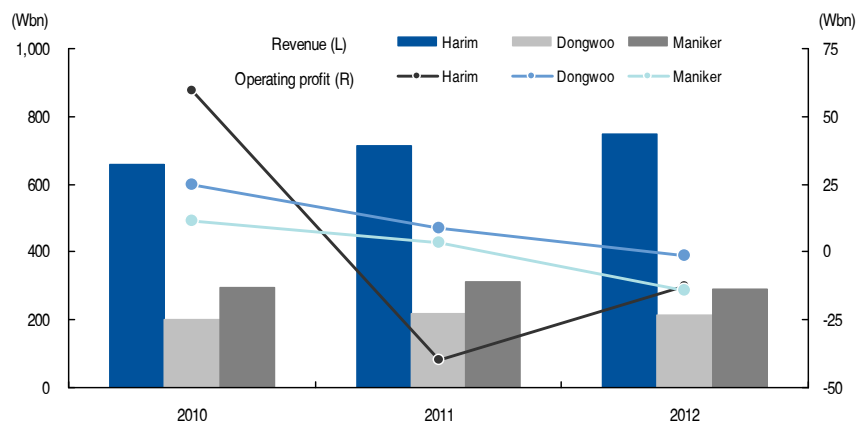
Easy Bio’s flagship business interests are animal feed and livestock. Key issues facing these divisions are noted below:

**Animal feed.** The animal feed industry has already gone through restructuring. In 2011, Easy Bio and Cargill held Korean market shares of 7.0% and 14.4%, respectively (trailing market leader Nonghyup). Since Easy Bio acquired Easy Pharms in 1H12, it has gained a market share of over 9%. As the company has strengthened its market position, we believe that it can now focus on improving profitability by controlling its fixed costs. The profitability of the feed unit, which makes a contribution of over 50% to consolidated revenue, is highly sensitive to changes in the prices of grains and legumes such as corn and soybeans. We expect the unit’s profitability to remain on the uptrend thanks to won appreciation. The US Department of Agriculture does not expect significant changes in corn prices, but, even if prices rise due to unforeseen events, Easy Bio can easily control its cost ratio (relative to its rivals) because it directly produces grain in Russia.

**Livestock.** Easy Bio’s livestock business may report a smaller loss this year, as government intervention should help ease oversupply in the market. For the past three years, chicken and pig prices declined despite rising feed prices, causing top-tier poultry firms to report losses in 2012, with bottom-tier firms suffering even more.

Chicken prices climbed 5.1% YoY at end-2012, but pig prices dropped 42.5% due to oversupply. The good news is that the government recently started to control supply with a 10% reduction target to help stabilize livestock prices. Thus, we expect Maniker’s earnings to improve this year, and Easy Bio’s consolidated net profit to surge if Maniker at least breaks even.

Figure 3. Revenue and operating profit of top three Korean poultry firms



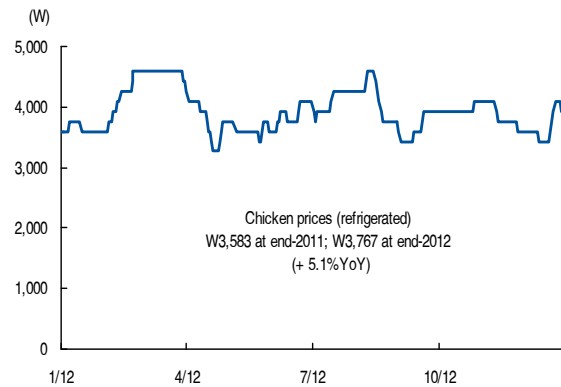
Source: Thomson Reuters, Datastream, KDB Daewoo Securities Research

**Figure 4. Pork prices fell 42.5 % YoY**



Source: Korea Meat Trade Association, KDB Daewoo Securities Research

**Figure 5. Chicken prices rose 5.1 % YoY**



Source: Korea Chicken Council, KDB Daewoo Securities Research

## 2. Exports of feed additives expanding

We believe overseas demand for feed additives will continue to swell, given changing dietary patterns worldwide that include a rising proportion of meat in diets. Feed additives are designed to reduce the time needed to raise nutritionally-enhanced livestock. According to the Food and Agriculture Organization (FAO), the global animal feed/supplement market—including nutrition enhancement, health enhancement, veterinary medicine, and veterinary diagnostics—is worth W35tr. In particular, the feed additive market—including amino acids, vitamins, enzymes, and minerals—amounts to W12.5tr, accounting for 36% of the overall animal feed/supplement market.

Notably, Easy Bio’s feed additive exports started to jump from 2012, thanks to the rise in demand for additives to enhance production yields, along with rising grain prices. Notably, the company has been able to expand its export customer base for its additives, Endonase Plus and Lipidol, to US-based grain producer ADM, in addition to increased exports to Latin America and Asia

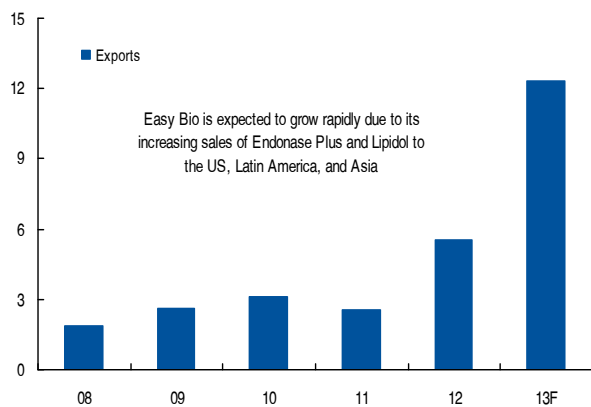
**Table 2. Veterinary medicine and feed additive revenue**

(Wbn)

	2007	2008	2009	2010	2011
Revenue	409.9	429.3	470.3	559.4	595.3
Growth	-0.5%	4.7%	11.0%	18.9%	6.5%

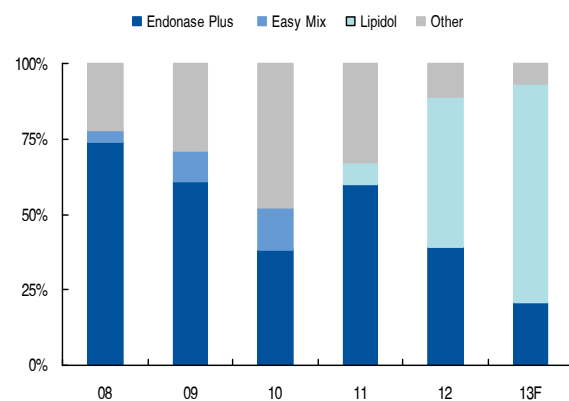
Source: Korea Animal Health Product Association, KDB Daewoo Securities Research

**Figure 6. Exports have begun to grow full swing**



Source: Company data, KDB Daewoo Securities Research

**Figure 7. Increasing sales of Lipidol**



Source: Company data, KDB Daewoo Securities Research

### 3. Value of biotech subsidiary to grow

Easy Bio's biotech subsidiary, Optifarm Solution, is considered Korea's leading livestock diagnostic company, which has enabled it to expand its business reach into human diagnostics. Notably, the company has recently developed tissues that are histocompatible with the human body (which enable organ transplants).

Optifarm Solution engages in the veterinary diagnostics, R&D, specific pathogen-free (SPF) livestock, and veterinary medicine businesses. It was founded in July 2006 through the establishment of an animal hospital. Shortly thereafter, it merged with two stem cell research institutes (i.e., Avicore Biotechnology Institute and Medipig) in January 2008, along with acquiring a veterinary medicine producer in April 2008.

The company's research efforts are extensive. For example, its SPF livestock unit is developing bacteriophage (an antibiotic substitute) in-house. And it is conducting research on artificial organs in partnership with Samsung Medical Center (under the eye of the Ministry of the Food and Drug Safety). Additionally, its veterinary medicine unit is developing and selling vaccines, antibiotics, and additives. Importantly, Optifarm Solution recently cloned hogs using enhanced green fluorescent protein (EGFP) genes. Based on this success, the company plans to clone animals designed for studying Alzheimer's disease and diabetes in 2H and for artificial organs in 1H14.

Looking ahead, we expect Optifarm Solution to become Easy Bio's major growth driver. While Optifarm Solution posted revenue of only W5.2bn in 2011 we expect the company will generate revenue of more than W10bn in 2013, as well as swing to a net profit. Furthermore, we expect the company will pursue a market listing in 2014, which should generate high market interest.

## Valuation

We initiate our coverage of Easy Bio System with a Buy rating and a target price of W9,000, implying a 137% upside. Given the hidden value of company’s subsidiary holdings, we believe the company’s fair value is best reflected through a blended average of two methodologies, as shown in <Table 3> below.

### SOTP valuation: Target price of W7,000

For the sum of the parts valuation, we applied an F&B industry average P/E of 20x to 2013F net profit to compute the value of the parent company, and a market P/E of 8.9x to 2013F net profit for FarmStory Hannaeng. To calculate the value of Optifarm, we used the market cap of a comparable firm, iNtRON Biotechnology, and, for Maniker, we recognized Easy Bio’s stake as a proportion of the company’s market cap.

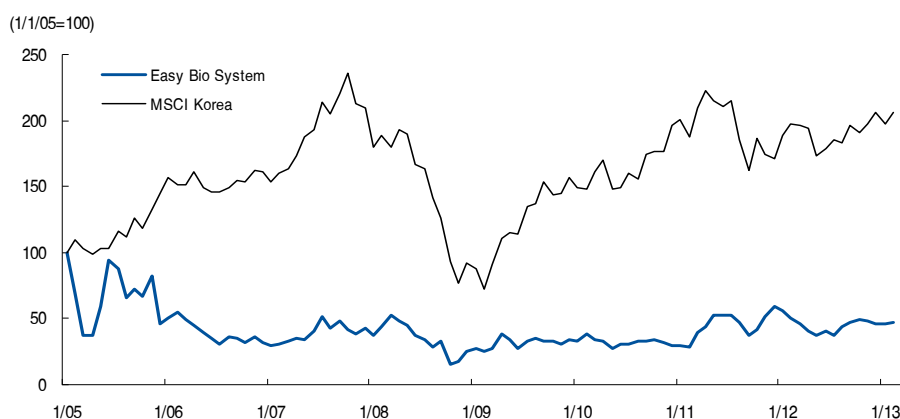
**Table 3. Target price calculation based on a sum-of-the-parts valuation** (Wbn, W)

	Comments	Value	
		2013	2014
Operating value (A, Wbn)	Applied F&B sector’s average P/E of 20x to a 2013F net profit	348.4	436.8
Subsidiaries’ value (B, Wbn)		309.8	309.8
- OptiFarm Solution	iNtRON Biotechnology’s market cap	175.1	175.1
- FarmStory Hannaeng	Applied a market P/E to a 2013F net profit	134.7	134.7
Investment assets (C, Wbn)		15.2	15.2
- Maniker (stake of 23.42%)	March 26 <sup>th</sup> closing price of W640	15.2	15.2
- Investment securities		4.4	4.4
<b>Corporate value (D= A+B+C, Wbn)</b>		<b>673.4</b>	<b>761.8</b>
Net borrowings (E)	As of end-4Q12 (consolidated)	370.6	370.6
<b>NAV (F=D-E, Wbn)</b>		<b>302.8</b>	<b>391.2</b>
No. of outstanding shares (G, mn)	46,979,739	4.7	4.7
<b>NAV per share (H=F/G, W)</b>		<b>6,445</b>	<b>8,327</b>
Current price (W)		3,800	
<b>Blended target price (W)</b>		<b>9,000</b>	

Note: Domestic F&B sector’s average P/E: 20x

Source: Company Data, KDB Daewoo Securities Research

**Figure 8. Easy Bio’s stock price vs. MSCI Korea**

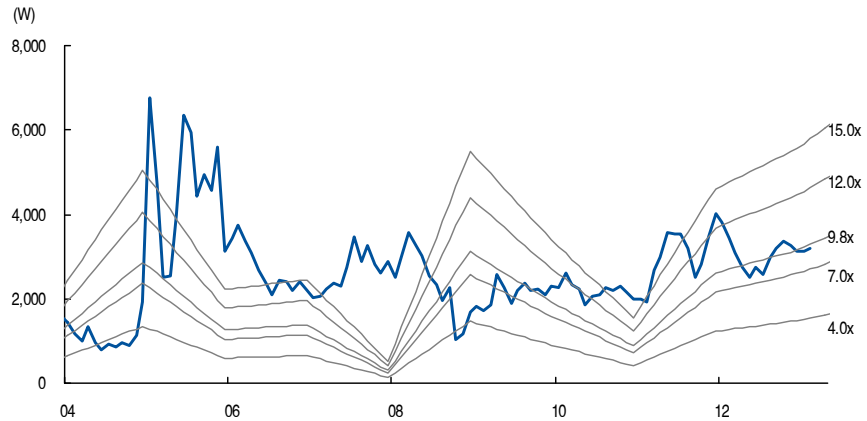


Source: DataGuide, KDB Daewoo Securities Research

**P/E valuation: Target price of W11,000**

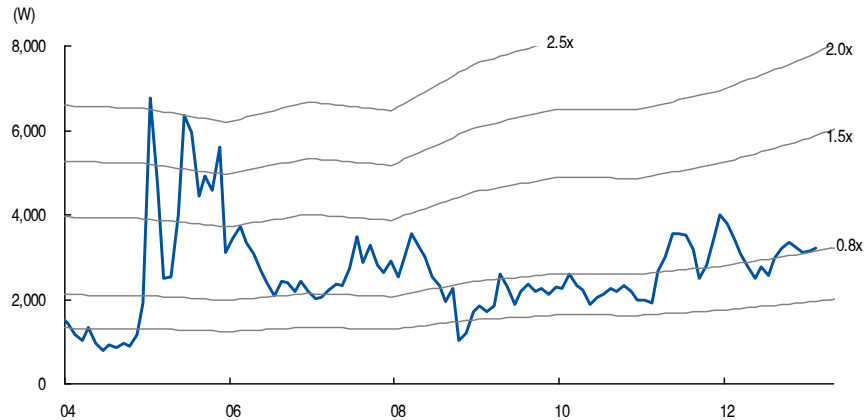
For the P/E valuation, we applied an F&B industry average P/E of 20x to our consolidated 2013F EPS (W565; resulting in target price of W11,000). We believe the high earnings multiple is justified in light of the company's rising margins. After achieving integration in its primary industry businesses, Easy Bio System is now improving margins by removing grain price hike risks and reducing fixed costs through directly-operating grain farms in Russia. In addition, the potential for top-line growth remains strong, as the company has expanded its animal feed additive exports.

**Figure 9. 12-month forward P/E band**



Source: KDB Daewoo Securities Research

**Figure 10. 12-month forward P/B band**



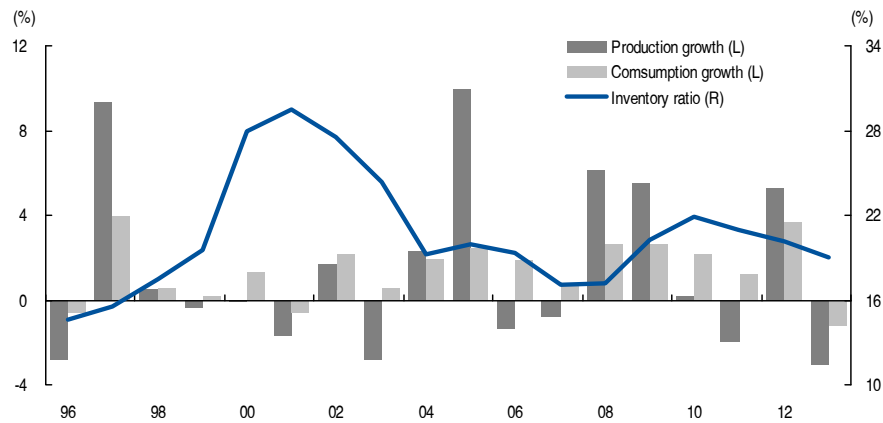
Source: KDB Daewoo Securities Research

## Risks

### Changes in F/X rates and grain prices

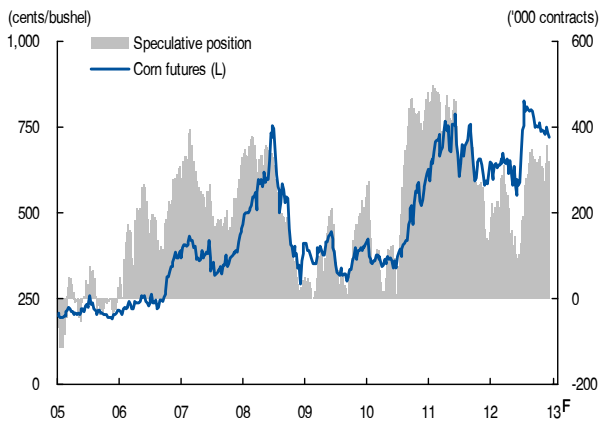
Easy Bio System’s animal feed business is exposed to risks of grain price fluctuations and F/X rate changes. International grain prices have trended downward since early-September 2012, as grain yields in the US have improved more than expected and grain production in South America is anticipated to recover. The USDA projects international grain prices will be on a smooth decline in 1H13. In addition, a strong dollar, easing inflation in the global economy, and international oil price declines are also depressing grain prices.

Figure 11. Global grain production and consumption (incl. 2013 forecasts)



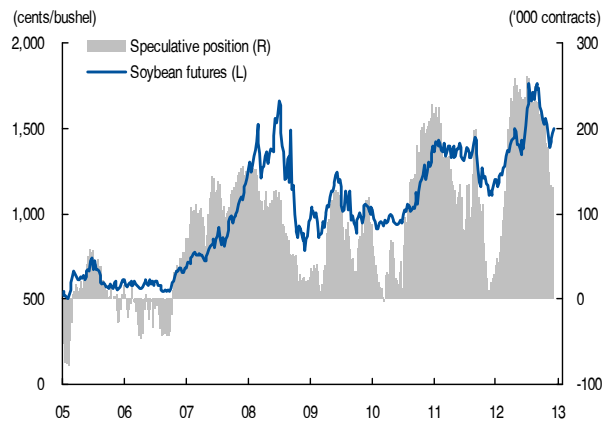
Source: USDA, KDB Daewoo Securities Research

Figure 12. Corn futures and speculative positions



Source: USDA, KDB Daewoo Securities Research

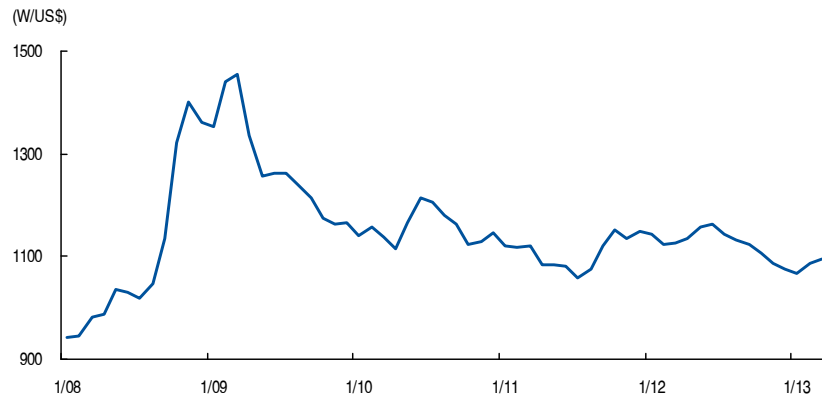
Figure 13. Soybean futures and speculative positions



Source: USDA, KDB Daewoo Securities Research

The US\$/W rate directly affects Easy Bio’s cost ratio, as the company relies heavily on imports for raw materials (grain) and most of its payments are made in dollars. In light of a stabilizing won after a surge in value in 2H12, the US\$/W rate is likely to have only a limited impact on the company’s cost ratio.

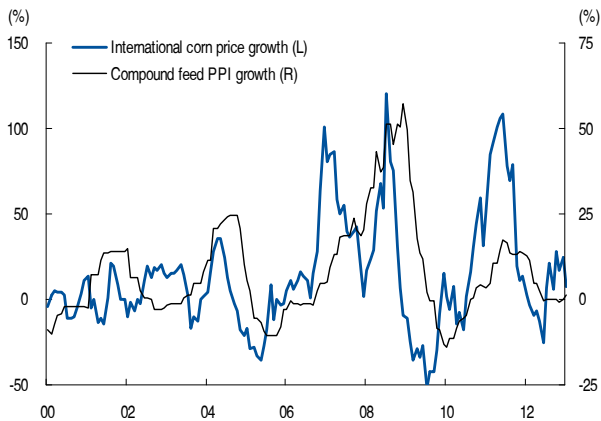
**Figure 14. US\$/W rate trend**



Source: Datastream, KDB Daewoo Securities Research

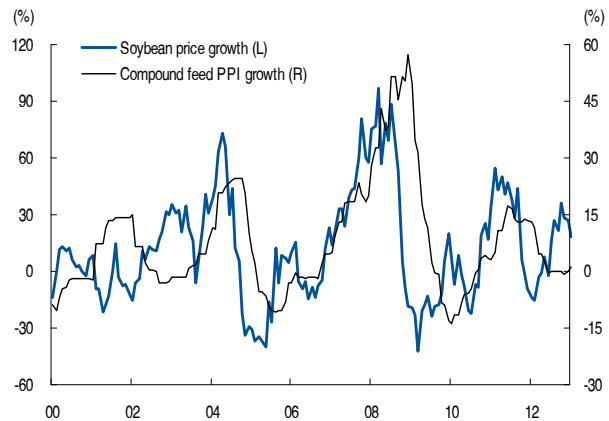
International corn prices in 1H13 are lower than the 2H12 levels, but higher than 1H12 levels. Despite an increase in cultivation areas, dwindling global production volume (estimated to decline by 3.6% YoY) due to climate changes, combined with growing consumption of animal feed-use corn, are pushing up prices.

**Figure 15. Animal feed price hikes after corn price increases**



Source: USDA, KDB Daewoo Securities Research

**Figure 16. Animal feed price hikes after soybean price increases**



Source: USDA, KDB Daewoo Securities Research

However, Easy Bio System has significantly reduced risks related to grain price hikes, as well as lowered fixed costs through the vertical integration of its farming, animal feed production, and distribution businesses. In addition, in an effort to secure stable growth in revenues and margins, the company is continuing to actively pursue M&A opportunities, along with expanding its overseas farming business in Russia and Asia. We expect that the direct operation of corn farms should lower the volatility of Easy Bio's exposure to grain price hikes and F/X rate risks.

## Easy Bio System (035810 KQ/Buy/TP: W9,000)

## Comprehensive Income Statement (Summarized)

(Wbn)	12/11	12/12P	12/13F	12/14F
<b>Revenue</b>	<b>95</b>	<b>127</b>	<b>140</b>	<b>163</b>
<b>Cost of Sales</b>	<b>67</b>	<b>89</b>	<b>97</b>	<b>111</b>
<b>Gross Profit</b>	<b>28</b>	<b>38</b>	<b>43</b>	<b>52</b>
<b>SG&amp;A Expenses</b>	<b>14</b>	<b>17</b>	<b>18</b>	<b>21</b>
<b>Operating Profit (Adj)</b>	<b>14</b>	<b>21</b>	<b>26</b>	<b>31</b>
<b>Operating Profit</b>	<b>13</b>	<b>21</b>	<b>26</b>	<b>31</b>
<b>Non-Operating Profit</b>	<b>-3</b>	<b>-1</b>	<b>-2</b>	<b>-1</b>
Net Financial Income	5	6	5	4
Net Gain from Inv in Associates	2	0	0	0
Pretax Profit	11	19	23	29
Income Tax	6	5	6	7
Profit from Continuing Operations	5	14	17	22
Profit from Discontinued Operations	0	0	0	0
<b>Net Profit</b>	<b>5</b>	<b>14</b>	<b>17</b>	<b>22</b>
Controlling Interests	5	14	17	22
Non-Controlling Interests	0	0	0	0
<b>Total Comprehensive Profit</b>	<b>5</b>	<b>14</b>	<b>17</b>	<b>22</b>
Controlling Interests	5	14	17	22
Non-Controlling Interests	0	0	0	0
EBITDA	15	21	26	31
FCF (Free Cash Flow)	-16	4	17	16
EBITDA Margin (%)	15.8	16.8	18.8	19.2
Operating Profit Margin (%)	13.9	16.1	18.2	18.7
Net Profit Margin (%)	5.0	11.4	12.5	13.4

## Cash Flows (Summarized)

(Wbn)	12/11	12/12P	12/13F	12/14F
<b>Cash Flows from Op Activities</b>	<b>7</b>	<b>10</b>	<b>17</b>	<b>16</b>
Net Profit	5	14	17	22
Non-Cash Income and Expense	12	8	9	9
Depreciation	1	1	1	1
Amortization	0	0	0	0
Others	-1	4	2	2
Chg in Working Capital	-8	-3	-3	-8
Chg in AR & Other Receivables	-4	-1	-3	-6
Chg in Inventories	-2	-4	-2	-3
Chg in AP & Other Payables	-4	-1	1	3
Income Tax Paid	-2	-9	-6	-7
<b>Cash Flows from Inv Activities</b>	<b>-32</b>	<b>35</b>	<b>23</b>	<b>23</b>
Chg in PP&E	-3	-2	0	0
Chg in Intangible Assets	0	0	0	0
Chg in Financial Assets	5	17	0	0
Others	-33	20	23	23
<b>Cash Flows from Fin Activities</b>	<b>27</b>	<b>-22</b>	<b>-6</b>	<b>-6</b>
Chg in Financial Liabilities	34	-10	0	0
Chg in Equity	0	0	0	0
Dividends Paid	-2	-2	0	0
Others	-5	-10	-6	-6
<b>Increase (Decrease) in Cash</b>	<b>3</b>	<b>23</b>	<b>34</b>	<b>34</b>
Beginning Balance	18	20	43	77
Ending Balance	20	43	77	110

Source: Company data, KDB Daewoo Securities Research estimates

## Statement of Financial Condition (Summarized)

(Wbn)	12/11	12/12P	12/13F	12/14F
<b>Current Assets</b>	<b>83</b>	<b>106</b>	<b>146</b>	<b>189</b>
Cash and Cash Equivalents	20	43	77	110
AR & Other Receivables	24	32	36	42
Inventories	12	16	18	21
Other Current Assets	5	7	8	9
<b>Non-Current Assets</b>	<b>217</b>	<b>208</b>	<b>189</b>	<b>173</b>
Investments in Associates	44	48	48	48
Property, Plant and Equipment	28	29	28	27
Intangible Assets	1	1	1	1
<b>Total Assets</b>	<b>301</b>	<b>314</b>	<b>335</b>	<b>363</b>
<b>Current Liabilities</b>	<b>120</b>	<b>125</b>	<b>128</b>	<b>134</b>
AP & Other Payables	11	15	16	19
Short-Term Financial Liabilities	95	91	91	91
Other Current Liabilities	15	20	22	25
<b>Non-Current Liabilities</b>	<b>31</b>	<b>26</b>	<b>26</b>	<b>26</b>
Long-Term Financial Liabilities	18	12	12	12
Other Non-Current Liabilities	13	13	13	13
<b>Total Liabilities</b>	<b>151</b>	<b>150</b>	<b>154</b>	<b>160</b>
<b>Controlling Interests</b>	<b>150</b>	<b>164</b>	<b>181</b>	<b>203</b>
Capital Stock	23	24	24	24
Capital Surplus	62	63	63	63
Retained Earnings	65	77	94	116
<b>Non-Controlling Interests</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>Stockholders' Equity</b>	<b>150</b>	<b>164</b>	<b>181</b>	<b>203</b>

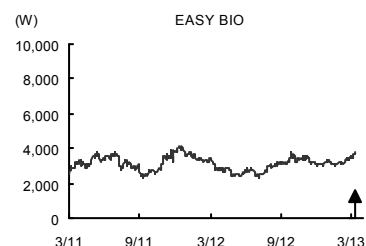
## Forecasts/Valuations (Summarized)

	12/11	12/12P	12/13F	12/14F
P/E (x)	38.7	10.2	10.3	8.2
P/CF (x)	29.5	9.6	9.8	7.9
P/B (x)	1.2	0.9	1.0	0.9
EV/EBITDA (x)	17.4	9.6	7.7	5.4
EPS (W)	104	307	371	465
CFPS (W)	136	324	388	482
BPS (W)	3,245	3,477	3,844	4,305
DPS (W)	50	0	0	0
Payout ratio (%)	48.2	0.0	0.0	0.0
Dividend Yield (%)	1.3	0.0	0.0	0.0
Revenue Growth (%)	15.7	33.5	10.0	16.7
EBITDA Growth (%)	-5.0	41.6	23.2	19.0
Operating Profit Growth (%)	-10.0	54.3	24.5	19.8
EPS Growth (%)	-54.1	195.9	20.9	25.4
Accounts Receivable Turnover (x)	6.1	6.7	6.2	6.3
Inventory Turnover (x)	8.5	8.9	8.2	8.4
Accounts Payable Turnover (x)	17.8	18.8	17.2	17.7
ROA (%)	1.7	4.7	5.4	6.3
ROE (%)	3.3	9.2	10.1	11.4
ROIC (%)	12.8	23.9	26.8	30.2
Liability to Equity Ratio (%)	100.5	91.6	84.8	78.9
Current Ratio (%)	69.2	85.3	113.8	141.1
Net Debt to Equity Ratio (%)	47.0	31.8	10.1	-7.6
Interest Coverage Ratio (x)	2.3	3.1	4.1	5.0

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