KDB Daewoo Securities

LS Industrial Systems

(010120 KS/Buy)

Beneficiary of nuclear reactor shutdowns

News Comment

June 3, 2013

Daewoo Securities Co., Ltd.

Shipbuilding/Machinery

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LSIS unrelated to JS Cable's defective supply

In the wake of the recent shutdown of two nuclear power plants (Shin Kori Reactor 2 and Shin Wolsong Reactor 1), the revelation of JS Cable's supply of defective cables sent shares of its parent, LS Group, tumbling. On the day of the news (May 30th), LS Industrial Systems (LSIS), a distant subsidiary of JS Cable with completely unrelated business, plummeted as much as 6% before closing down 4.2%. On the following day, the stock pared some of its losses, gaining 2.5%.

Power plant suspension to prove beneficial to LSIS

The shutdown of two additional nuclear reactors will undoubtedly take a toll on domestic power supply for some time. We believe the government will, in response, step up its efforts to increase power plant capacity (mainly in thermal power, private power generators and alternative power) and expand smart grid penetration to improve energy efficiency.

We believe such moves will contribute to LSIS's top-line growth, as capacity additions should drive demand for related electrical equipment, while increased spending on smart grids should provide a boost to the firm's smart grid business. Thus, although the nuclear reactor suspension may appear to be negative to electric equipment suppliers in the near term, this should ultimately prove positive to LSIS over the long term.

Recent share pullback offers buying opportunity; Expect solid top-line growth

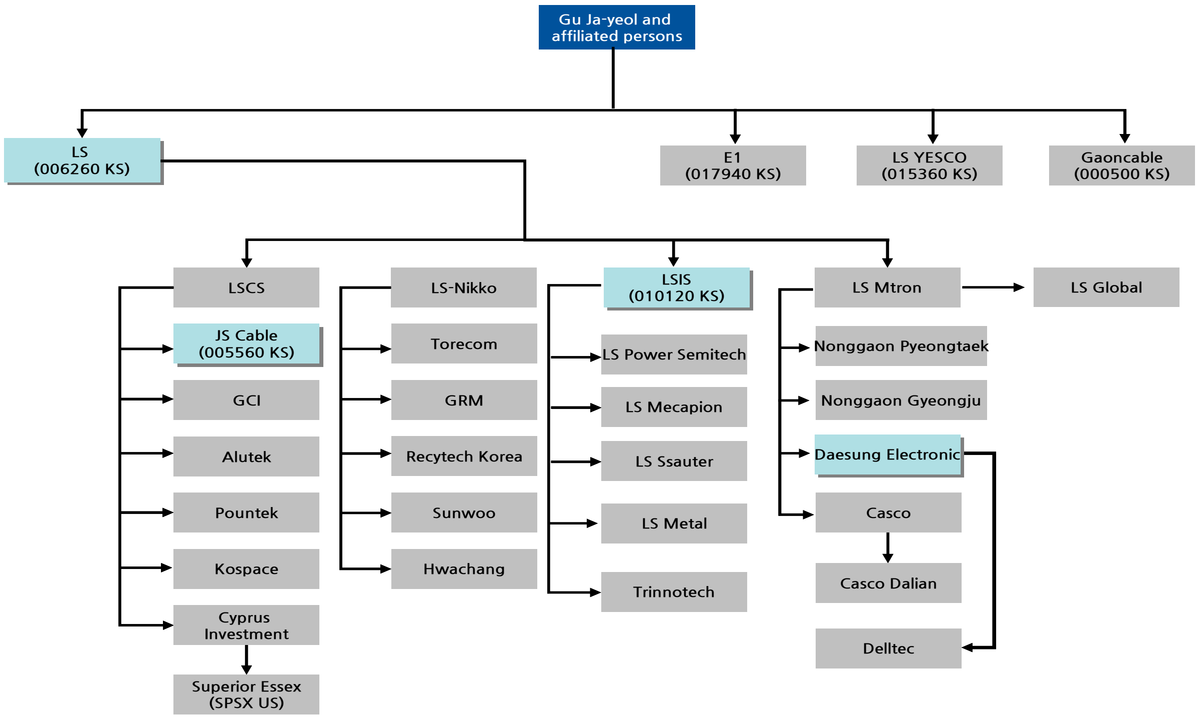
We reiterate our Buy call on LSIS with a target price of W75,000. The recent power plant shutdown and JS Cable's supply of faulty cables is unlikely to inflict any damage on LSIS. Rather, the resulting lower utilization of nuclear power plants should lead to more advanced power generation systems and capacity expansions, proving beneficial to the company. As such, we believe investors should take advantage of the recent share pullback as a buying opportunity.

The stock is currently trading at a 2013F P/E of 12.8x, a premium to the broader manufacturing industry (average P/E of 10x). Still, the stock appears undervalued compared with its global peers (20.3x), which are trading at above-30% premiums to their respective markets, thanks to their monopolistic positions, noncyclical nature and business stability. We believe LSIS has the potential to deliver top-line growth of 10%-20% CAGR in the coming years on exports and expansion into new business areas. In our view, LSIS has a balanced business profile that offers both growth and stability.

FY (Dec.)	12/10	12/11	12/12	12/13F	12/14F	12/15F
Revenue (Wbn)	1,835	2,071	2,232	2,561	2,980	3,468
OP (Wbn)	174	132	154	194	238	302
OP Margin (%)	9.5	6.4	6.9	7.6	8.0	8.7
NP (Wbn)	123	70	100	143	183	234
EPS (W)	4,112	2,346	3,344	4,759	6,094	7,788
ROE (%)	17.9	9.4	12.5	16.5	19.2	21.2
P/E (x)	22.0	28.4	20.1	12.8	10.0	7.8
P/B (x)	4.1	3.0	2.8	2.5	2.2	1.8

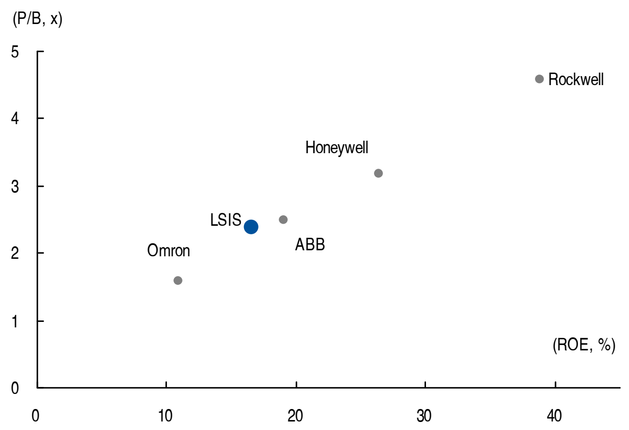
Note: All figures are based on consolidated K-IFRS; NP refers to profit attributable to controlling interests
Source: Company data, KDB Daewoo Securities Research estimates

Figure 1. LS Group structure



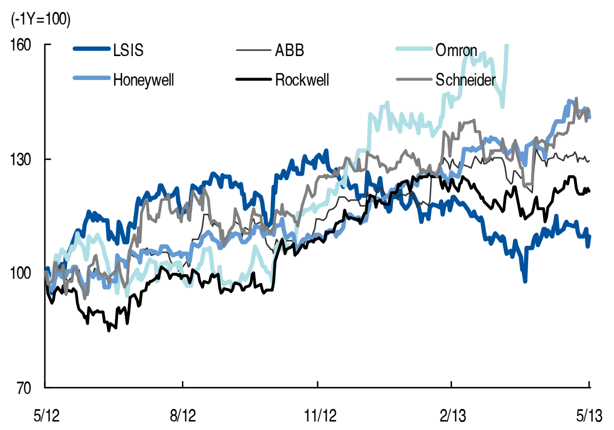
Source: Company data

Figure 2. P/B-ROE of LSIS and major peers (2013F)



Source: Thomson Reuters, KDB Daewoo securities research

Figure 3. Share price of LSIS and major peers



Source: Thomson Reuters, KDB Daewoo securities research

LS Industrial Systems (010120 KS/Buy/TP: W75,000)

Comprehensive Income Statement (Summarized)

(Wbn)	12/12	12/13F	12/14F	12/15F
Revenue	2,232	2,561	2,980	3,468
Cost of Sales	1,827	2,086	2,420	2,792
Gross Profit	406	475	560	676
SG&A Expenses	252	282	322	375
Operating Profit (Adj)	154	194	238	302
Operating Profit	154	194	238	302
Non-Operating Profit	-20	-6	1	4
Net Financial Income	25	23	22	20
Net Gain from Inv in Associates	-9	-5	0	0
Pretax Profit	134	188	240	305
Income Tax	31	42	54	69
Profit from Continuing Operations	104	146	186	237
Profit from Discontinued Operations	-6	-3	-3	-3
Net Profit	97	143	183	234
Controlling Interests	100	143	183	234
Non-Controlling Interests	-3	0	0	0
Total Comprehensive Profit	77	123	163	214
Controlling Interests	80	123	163	214
Non-Controlling Interests	-3	0	0	0
EBITDA	233	268	315	374
FCF (Free Cash Flow)	-6	101	105	179
EBITDA Margin (%)	10.4	10.5	10.6	10.8
Operating Profit Margin (%)	6.9	7.6	8.0	8.7
Net Profit Margin (%)	4.5	5.6	6.1	6.7

Statement of Financial Condition (Summarized)

(Wbn)	12/12	12/13F	12/14F	12/15F
Current Assets	1,157	1,180	1,230	1,434
Cash and Cash Equivalents	176	153	106	131
AR & Other Receivables	680	704	775	902
Inventories	233	251	274	319
Other Current Assets	37	41	45	52
Non-Current Assets	863	893	928	897
Investments in Associates	8	3	3	3
Property, Plant and Equipment	668	680	689	636
Intangible Assets	150	170	188	205
Total Assets	2,020	2,073	2,158	2,332
Current Liabilities	604	587	602	638
AP & Other Payables	383	397	432	503
Short-Term Financial Liabilities	149	109	79	29
Other Current Liabilities	73	81	91	106
Non-Current Liabilities	579	591	544	498
Long-Term Financial Liabilities	510	510	460	410
Other Non-Current Liabilities	29	36	39	43
Total Liabilities	1,183	1,177	1,146	1,136
Controlling Interests	834	893	1,009	1,193
Capital Stock	150	150	150	150
Capital Surplus	1	1	1	1
Retained Earnings	711	789	925	1,129
Non-Controlling Interests	3	3	3	3
Stockholders' Equity	838	896	1,012	1,196

Cash Flows (Summarized)

(Wbn)	12/12	12/13F	12/14F	12/15F
Cash Flows from Op Activities	133	210	207	210
Net Profit	104	143	183	234
Non-Cash Income and Expense	155	122	130	138
Depreciation	62	59	60	54
Amortization	17	15	17	19
Others	-7	24	24	24
Chg in Working Capital	-115	-13	-52	-93
Chg in AR & Other Receivables	-160	-24	-70	-127
Chg in Inventories	-18	-18	-23	-45
Chg in AP & Other Payables	56	14	35	71
Income Tax Paid	-11	-42	-54	-69
Cash Flows from Inv Activities	-122	-99	-100	-31
Chg in PP&E	-97	-70	-70	0
Chg in Intangible Assets	-38	-35	-35	-35
Chg in Financial Assets	-2	0	0	0
Others	15	6	6	4
Cash Flows from Fin Activities	40	-134	-155	-154
Chg in Financial Liabilities	86	-40	-80	-100
Chg in Equity	0	0	0	0
Dividends Paid	-18	-47	-47	-29
Others	-29	-30	-28	-24
Increase (Decrease) in Cash	51	-24	-47	25
Beginning Balance	125	176	153	106
Ending Balance	176	153	106	131

Forecasts/Valuations (Summarized)

	12/12	12/13F	12/14F	12/15F
P/E (x)	20.1	12.8	10.0	7.8
P/CF (x)	11.2	8.4	7.0	6.0
P/B (x)	2.8	2.5	2.2	1.8
EV/EBITDA (x)	10.8	8.7	7.2	5.8
EPS (W)	3,344	4,759	6,094	7,788
CFPS (W)	5,975	7,225	8,662	10,204
BPS (W)	23,647	24,926	28,191	33,793
DPS (W)	1,000	600	1,000	0
Payout ratio (%)	29.2	12.3	16.0	0.0
Dividend Yield (%)	1.5	1.0	1.6	0.0
Revenue Growth (%)	7.8	14.7	16.3	16.4
EBITDA Growth (%)	14.9	14.8	17.9	18.6
Operating Profit Growth (%)	17.2	25.6	23.1	26.6
EPS Growth (%)	42.5	42.3	28.0	27.8
Accounts Receivable Turnover (x)	3.7	3.7	4.0	4.1
Inventory Turnover (x)	9.9	10.6	11.4	11.7
Accounts Payable Turnover (x)	6.2	6.6	7.2	7.4
ROA (%)	5.1	7.0	8.6	10.4
ROE (%)	12.5	16.5	19.2	21.2
ROIC (%)	9.4	11.2	13.2	15.9
Liability to Equity Ratio (%)	141.2	131.4	113.3	95.0
Current Ratio (%)	191.5	201.1	204.4	225.0
Net Debt to Equity Ratio (%)	53.9	48.6	39.8	23.2
Interest Coverage Ratio (x)	5.4	6.5	8.6	12.4

Source: Company data, KDB Daewoo Securities Research estimates

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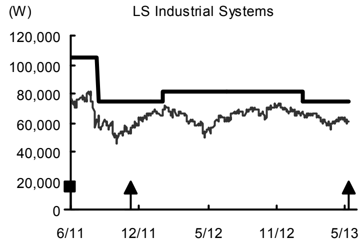

Stock Ratings		Industry Ratings	
Buy	Relative performance of 20% or greater	Overweight	Fundamentals are favorable or improving
Trading Buy	Relative performance of 10% or greater, but with volatility	Neutral	Fundamentals are steady without any material changes
Hold	Relative performance of -10% and 10%	Underweight	Fundamentals are unfavorable or worsening
Sell	Relative performance of -10%		

* Ratings and Target Price History (Share price (----), Target price (----), Not covered (■), Buy (▲), Trading Buy (■), Hold (●), Sell (◆))
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