

# Samsung Engineering

(028050 KS)

## Unattractive valuation

### Construction

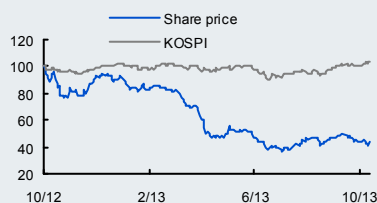
#### Results Comment

October 21, 2013

(Downgrade)	<b>Hold</b>
Target Price (12M, W)	-
Share Price (10/18/13, W)	80,100
Expected Return	-

OP (13F, Wbn)	-1,001
Consensus OP (13F, Wbn)	-262
EPS Growth (13F, %)	TTR
Market EPS Growth (13F, %)	19.5
P/E (13F, x)	-
Market P/E (13F, x)	10.8
KOSPI	2,052.40
Market Cap (Wbn)	3,204
Shares Outstanding (mn)	40
Free Float (%)	71.3
Foreign Ownership (%)	26.7
Beta (12M)	1.57
52-Week Low (W)	67,500
52-Week High (W)	179,000

(%)	1M	6M	12M
Absolute	-12.8	-11.2	-54.4
Relative	-15.1	-19.2	-59.1



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### More cost adjusted projects emerge in 3Q

Despite massive overseas cost adjustments in 1H, Samsung Engineering recorded another huge loss in 3Q due to further cost overruns.

1) Delays in projects originally due for completion in 2013 (W305bn in additional costs): The Ma'aden rolling mill project (previously set to come online on Dec 16<sup>th</sup>; additional workforce deployed and rush work underway), the Dow Chemical project (originally due in Sep; extended two months due to quality issues), the CO2 compression project in Saudi Arabia (equipment delivery delayed), the Jubail 3 refinery project (delayed three months) and the UAE Takreer RRE refinery project (originally due in August; delayed four months).

2) Cost adjustments for projects due for completion in 2014: The Shaybah NGL plant project (all four packages) is so far 66% complete and is scheduled to be finished in July 2014. Costs of W120bn were reflected in 2Q and another W215bn in 3Q. The cost overrun was caused by problems with hiring at subcontractors (labor, subcontractor replacement and rush work-related costs).

3) Cost adjustments for projects that should generate accelerated revenue: For the UAE carbon black project (order backlog of W2.6tr as of end-2Q; detail design completed in end-August), the company has set aside W170bn in loss provisions, due to equipment order overruns, increased labor costs and the withdrawal of several optional provisions.

4) Projects that have not incurred losses but still slow to bring revenue: The Kazakh power plant project (order backlog of W2.3tr; EPC contract not yet signed; only the design contract has been concluded) and the Yanbu power plant project (order backlog of W1.7tr).

### Three reasons why a post-big bath turnaround is unlikely

1) Margins unlikely to improve: We see risks of further delays in already extended-projects. Even if there are no more losses, the Shaybah and UAE carbon black projects should continue to act as a drag.

2) Marked decline in revenue in 2014: The Yanbu power plant project (order backlog of W2.3tr as of end-2Q), carbon black project (W2.6tr) and the Kazakh power plant project (W2.3tr), which account for a large portion of the firm's order backlog, are unlikely to generate revenues at a meaningful rate.

3) We see three negatives from a long-term perspective: 1) the decline in BPS caused by the sizeable 3Q losses, 2) the stock's resulting high valuation, and 3) interest expenses and rising debt ratio due to increasing net debt.

### Downgrade to Hold

The massive losses in 3Q have eroded the stock's BPS, making the current valuation unattractive. As such, we downgrade our rating on Samsung Engineering to Hold from Trading Buy.

FY (Dec.)	12/10	12/11	12/12	12/13F	12/14F	12/15F
Revenue (Wbn)	5,312	9,298	11,440	9,942	8,677	8,484
OP (Wbn)	412	626	732	-1,001	217	275
OP Margin (%)	7.8	6.7	6.4	-10.1	2.5	3.2
NP (Wbn)	339	513	524	-821	119	194
EPS (W)	8,482	12,832	13,095	-20,520	2,986	4,839
ROE (%)	38.3	43.7	33.9	-65.8	14.6	20.7
P/E (x)	22.6	15.7	12.6	-	26.8	16.6
P/B (x)	6.1	5.0	3.3	3.2	2.9	2.6

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

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Table 1. 3Q13P earnings results

(Wbn, %, %p)

	3Q12	2Q13	3Q13P			Growth	
			Preliminary	KDB Daewoo	Consensus	YoY	QoQ
Revenue	2,862	2,657	1,945	2,663	2,670	-32.1	-26.8
OP	184	-89	-747	-45	11	TTR	RR
Pretax profit	177	-97	-771	-55	21	TTR	RR
Net profit	124	-93	-524	-42	2	TTR	RR
OP margin	6.4	-3.3	-38.4	-1.7	0.4	-44.8	-35.1
NP margin	4.3	-3.5	-27.0	-1.6	0.1	-31.3	-23.5

Notes: Consolidated K-IFRS basis; NP refers to net profit attributable to controlling interests

Source: Company data, FnGuide, KDB Daewoo Securities Research estimates

Table 2. Earnings forecast revisions

(Wbn, W, %, %p)

	Previous		Revised		% change		Notes
	2013F	2014F	2013F	2014F	2013F	2014F	
Revenue	10,811	9,751	9,942	8,677	-8.0	-11.0	- Sluggish new orders
OP	-253	368	-1,001	217	RR	-41.0	- Additional project delays overseas
Pretax profit	-226	344	-1,004	156	RR	-54.6	- Increased interest expenses
Net profit	-231	262	-821	119	RR	-54.4	
EPS	-5,780	6,543	-20,520	2,986	RR	-54.4	
OP margin	-2.3	3.8	-10.1	2.5	-7.7	-1.3	
NP margin	-2.1	2.7	-8.3	1.4	-6.1	-1.3	

Notes: Consolidated K-IFRS basis; NP refers to net profit attributable to controlling interests

Source: KDB Daewoo Securities Research estimates

Table 3. Quarterly and annual earnings

(Wbn, %, %p)

	2012		2013				2014		3Q13P		2011	2012	2013F	2014F
	3Q	4Q	1Q	2Q	3QP	4QF	1QF	2QF	YoY	QoQ				
Revenue	2,862	2,809	2,516	2,657	1,945	2,824	1,960	2,437	-32.1	-26.8	9,298	11,440	9,942	8,677
OP	184	170	-220	-89	-747	49	31	91	TTR	RR	626	732	-1,001	217
Pretax profit	177	142	-184	-97	-771	49	19	72	TTR	RR	687	701	-1,004	156
Net profit	124	112	-180	-93	-524	37	15	54	TTR	RR	513	524	-821	119
OP margin	6.4	6.1	-8.7	-3.3	-38.4	1.7	1.6	3.7	-44.8	-35.1	6.7	6.4	-10.1	2.5
NP margin	4.3	4.0	-7.1	-3.5	-27.0	1.3	0.8	2.2	-31.3	-23.5	5.5	4.6	-8.3	1.4

Notes: Consolidated K-IFRS basis; NP refers to net profit attributable to controlling interests

Source: Company data, KDB Daewoo Securities Research estimates

Table 4. Projects with additional cost adjustments

(Wbn)

Ordering company	Project name	Contract date	Expected completion date	Contract value	Contract balance	Additional costs
USA Dow-Mitsui Chlor-Alkali	Dow-Mitsui Falcon Project	11/2010	09/2013	461	29	20
Samsung Saudi Arabia	CO2 Compression	04/2011	01/2014	1,076	510	55
Ma'aden Rolling	Ma'aden Aluminum Rolling Mill	02/2011	03/2014	946	83	50
UAE Abu Dhabi Oil Refining	Takreer RRE Utilities & Offsite	12/2009	02/2014	3,101	219	100
Saudi Arabian Oil	Shaybah Increase Gas Handling	03/2011	05/2014	1,157	216	
Saudi Arabian Oil	Shaybah NGL Power Generation	03/2011	03/2014	616	70	215
Saudi Arabian Oil	Shaybah #1 Inlet & Gas Treatment	03/2011	06/2014	682	157	
Saudi Arabian Oil	Shaybah NGL #2 Recovery & Utilities	03/2011	07/2014	788	238	
Abu Dhabi Oil Refining	Takreer Carbon Black & Delayed Coker	07/2012	01/2016	2,843	2,550	170
Saudi Arabian Oil	JED (JERP #4 Coker Units)	07/2009	07/2013	487	30	40
Saudi Arabian Oil	JERP #3 Aromatics Units	07/2009	08/2013	771	12	

Source: Company data, KDB Daewoo Securities Research

## Samsung Engineering (028050 KS/Hold)

## Comprehensive Income Statement (Summarized)

(Wbn)	12/12	12/13F	12/14F	12/15F
<b>Revenue</b>	<b>11,440</b>	<b>9,942</b>	<b>8,677</b>	<b>8,484</b>
<b>Cost of Sales</b>	<b>10,153</b>	<b>10,461</b>	<b>7,967</b>	<b>7,702</b>
<b>Gross Profit</b>	<b>1,288</b>	<b>-519</b>	<b>710</b>	<b>782</b>
<b>SG&amp;A Expenses</b>	<b>555</b>	<b>482</b>	<b>493</b>	<b>507</b>
<b>Operating Profit (Adj)</b>	<b>732</b>	<b>-1,001</b>	<b>217</b>	<b>275</b>
<b>Operating Profit</b>	<b>732</b>	<b>-1,001</b>	<b>217</b>	<b>275</b>
<b>Non-Operating Profit</b>	<b>-32</b>	<b>-4</b>	<b>-61</b>	<b>-20</b>
Net Financial Income	6	35	67	57
Net Gain from Inv in Associates	11	4	4	4
Pretax Profit	701	-1,004	156	254
Income Tax	180	-183	38	62
Profit from Continuing Operations	<b>521</b>	<b>-822</b>	<b>119</b>	<b>193</b>
Profit from Discontinued Operations	0	0	0	0
<b>Net Profit</b>	<b>521</b>	<b>-822</b>	<b>119</b>	<b>193</b>
Controlling Interests	524	-821	119	194
Non-Controlling Interests	-3	-1	-1	-1
<b>Total Comprehensive Profit</b>	<b>517</b>	<b>-821</b>	<b>119</b>	<b>193</b>
Controlling Interests	519	-821	120	194
Non-Controlling Interests	-2	-1	-1	-1
EBITDA	792	-937	288	340
FCF (Free Cash Flow)	-415	-1,137	108	460
EBITDA Margin (%)	6.9	-9.4	3.3	4.0
Operating Profit Margin (%)	6.4	-10.1	2.5	3.2
Net Profit Margin (%)	4.6	-8.3	1.4	2.3

## Cash Flows (Summarized)

(Wbn)	12/12	12/13F	12/14F	12/15F
<b>Cash Flows from Op Activities</b>	<b>-186</b>	<b>-1,158</b>	<b>134</b>	<b>477</b>
Net Profit	521	-822	119	193
Non-Cash Income and Expense	335	-66	170	148
Depreciation	54	56	64	58
Amortization	6	7	7	8
Others	-69	-31	2	32
Chg in Working Capital	-864	-410	-116	198
Chg in AR & Other Receivables	-410	-213	250	238
Chg in Inventories	0	0	0	0
Chg in AP & Other Payables	-387	-56	-466	-56
Income Tax Paid	-178	140	-38	-62
<b>Cash Flows from Inv Activities</b>	<b>-165</b>	<b>-31</b>	<b>-7</b>	<b>-8</b>
Chg in PP&E	-214	-23	0	0
Chg in Intangible Assets	-12	-12	-12	-12
Chg in Financial Assets	59	-7	0	0
Others	1	9	5	4
<b>Cash Flows from Fin Activities</b>	<b>238</b>	<b>844</b>	<b>-172</b>	<b>-234</b>
Chg in Financial Liabilities	370	999	-100	-100
Chg in Equity	0	0	0	0
Dividends Paid	-111	-111	0	-74
Others	-21	-45	-72	-60
<b>Increase (Decrease) in Cash</b>	<b>-124</b>	<b>-307</b>	<b>-45</b>	<b>235</b>
Beginning Balance	560	436	129	85
Ending Balance	436	129	85	320

Source: Company data, KDB Daewoo Securities Research estimates

## Statement of Financial Condition (Summarized)

(Wbn)	12/12	12/13F	12/14F	12/15F
<b>Current Assets</b>	<b>4,188</b>	<b>4,233</b>	<b>3,850</b>	<b>3,833</b>
Cash and Cash Equivalents	436	129	85	320
AR & Other Receivables	3,108	3,331	3,080	2,842
Inventories	0	0	0	0
Other Current Assets	575	696	607	594
<b>Non-Current Assets</b>	<b>1,486</b>	<b>1,442</b>	<b>1,305</b>	<b>1,273</b>
Investments in Associates	1	17	21	26
Property, Plant and Equipment	733	705	642	584
Intangible Assets	40	43	47	51
<b>Total Assets</b>	<b>5,674</b>	<b>5,675</b>	<b>5,154</b>	<b>5,105</b>
<b>Current Liabilities</b>	<b>3,554</b>	<b>4,143</b>	<b>3,561</b>	<b>3,402</b>
AP & Other Payables	3,029	2,982	2,516	2,460
Short-Term Financial Liabilities	380	1,034	934	834
Other Current Liabilities	146	127	110	108
<b>Non-Current Liabilities</b>	<b>379</b>	<b>775</b>	<b>718</b>	<b>708</b>
Long-Term Financial Liabilities	3	403	403	403
Other Non-Current Liabilities	339	335	278	268
<b>Total Liabilities</b>	<b>3,934</b>	<b>4,918</b>	<b>4,279</b>	<b>4,111</b>
<b>Controlling Interests</b>	<b>1,740</b>	<b>757</b>	<b>877</b>	<b>997</b>
Capital Stock	200	200	200	200
Capital Surplus	49	49	49	49
Retained Earnings	1,771	845	964	1,084
<b>Non-Controlling Interests</b>	<b>1</b>	<b>0</b>	<b>-1</b>	<b>-2</b>
<b>Stockholders' Equity</b>	<b>1,740</b>	<b>757</b>	<b>876</b>	<b>995</b>

## Forecasts/Valuations (Summarized)

	12/12	12/13F	12/14F	12/15F
P/E (x)	12.6	-	26.8	16.6
P/CF (x)	11.3	-4.2	16.8	12.4
P/B (x)	3.3	3.2	2.9	2.6
EV/EBITDA (x)	8.3	-	15.3	12.0
EPS (W)	13,095	-20,520	2,986	4,839
CFPS (W)	14,596	-18,935	4,758	6,485
BPS (W)	49,612	24,964	27,856	30,770
DPS (W)	3,000	0	2,000	3,000
Payout ratio (%)	21.2	0.0	61.9	57.3
Dividend Yield (%)	1.8	0.0	2.5	3.8
Revenue Growth (%)	23.0	-13.1	-12.7	-2.2
EBITDA Growth (%)	19.2	TTR	TTB	18.1
Operating Profit Growth (%)	16.9	TTR	TTB	26.3
EPS Growth (%)	2.1	TTR	TTB	62.1
Accounts Receivable Turnover (x)	4.0	3.1	2.8	2.9
Inventory Turnover (x)				
Accounts Payable Turnover (x)	3.9	3.7	3.5	3.8
ROA (%)	9.6	-14.5	2.2	3.8
ROE (%)	33.9	-65.8	14.6	20.7
ROIC (%)	55.3	-46.9	9.0	12.0
Liability to Equity Ratio (%)	226.1	650.1	488.8	413.3
Current Ratio (%)	117.8	102.2	108.1	112.7
Net Debt to Equity Ratio (%)	-7.0	162.6	134.2	84.5
Interest Coverage Ratio (x)	37.0	-21.8	3.0	4.6

# APPENDIX 1

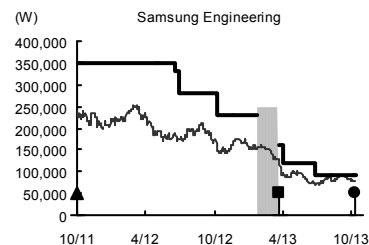
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Hold	Relative performance of -10% and 10%	Underweight	Fundamentals are unfavorable or worsening
Sell	Relative performance of -10%		

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