KDB Daewoo Securities

Food & Beverage

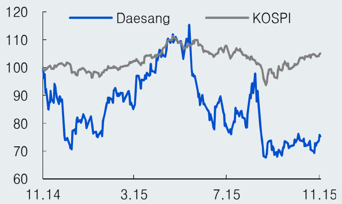
Earnings Preview

November 4, 2015

(Maintain)	**Buy**
Target Price (12M, W)	**50,000**
Share Price (11/4/15, W)	32,150
Expected Return	56%

OP (15F, Wbn)	122
Consensus OP (15F, Wbn)	126
EPS Growth (15F, %)	-26.6
Market EPS Growth (15F, %)	19.7
P/E (15F, x)	17.0
Market P/E (15F, x)	12.0
KOSPI	2,052.77
Market Cap (Wbn)	1,106
Shares Outstanding (mn)	36
Free Float (%)	55.0
Foreign Ownership (%)	12.9
Beta (12M)	1.69
52-Week Low	28,900
52-Week High	49,250

(%)	1M	6M	12M
Absolute	2.9	-31.2	-21.9
Relative	-1.3	-28.6	-26.3



Daewoo Securities Co., Ltd.

[F&B/Tobacco]

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Daesang
(001680 KS)

Bottom to be confirmed soon

3Q15 preview: Earnings appear to be stabilizing

In 3Q, we estimate Daesang's consolidated revenue and operating profit grew 1.9% and 9.8% YoY, respectively. Our operating profit estimate is W35.8bn, higher than the market consensus (W33.8bn). Although 3Q was not an especially good quarter, we see it as an improvement from the extensive weakness seen in the previous two quarters.

General food operating profit likely increased YoY on the back of 1) strong Chuseok holiday gift sales (which we think hit a record high), and 2) SG&A cost reductions. (Costs were high in 3Q14 and again in 1H15, when the company spent heavily on marketing to recapture fermented paste market share.) We believe Daesang stemmed its fermented paste market share losses in 3Q. Meanwhile, the Indonesia subsidiary and Daesang Bestco likely remained in the red due to higher costs.

Key issues for 2016

Looking ahead to 2016, we believe the biggest earnings determinants will be 1) the newly acquired lysine business, 2) Indonesia, 3) Daesang Bestco, and 4) fermented paste market share.

Daesang recently bought Paik Kwang Industrial's lysine business (annual capacity of 150,000 tonnes; 2014 revenue of W187.1bn and operating loss of W29.1bn) for W120.9bn (earnings to be included starting in November). We see potential synergies between lysine and the company's existing starch sugar business (in terms of raw material sourcing and utility cost savings), but an operating loss looks likely in 4Q15 as well as in 2016, as international lysine prices are falling due to oversupply.

Daesang is investing W70bn in Indonesia to enter the local starch sugar market. The company has had previous success with its venture in the Philippines. Once construction is completed (expected in late 2017), the Indonesia starch sugar plant will become the second largest in the country, with annual capacity of 200,000 tonnes (potential revenue of W100bn). We believe the company has several advantages, including an established client base (B2B), superior technology, and cost competitiveness. Daesang is also investing in a cogeneration plant in Indonesia to ensure stable electricity supply.

In 2H, Daesang Bestco shifted its strategic focus from growth to profitability (i.e., cost controls). As such, we expect losses to narrow from 4Q15 through 2016.

The fermented paste business has limited growth prospects (annual revenue estimated at W200bn) but is highly profitable. After declining in 1H, the company's market share should stabilize in 2016, partly thanks to marketing efforts. Meanwhile, we expect frozen food, Western food (sauces, dressings, home meal replacements (HMR), and red vinegar drink), and health food to continue growth in 2016.

Retain Buy, but Cut TP to W50,000

Daesang shares have corrected on disappointing earnings in 1H and news of the lysine and Indonesia investments. We believe a bottom will be confirmed soon, and thus advise taking an overweight position. That said, we lower our target price to W50,000 (from W58,000) in light of our 2016F earnings revisions.

FY (Dec.)	12/12	12/13	12/14	12/15F	12/16F	12/17F
Revenue (Wbn)	2,452	2,542	2,589	2,670	2,886	2,982
OP (Wbn)	130	156	140	122	121	130
OP margin (%)	5.3	6.1	5.4	4.6	4.2	4.4
NP (Wbn)	91	110	93	68	72	78
EPS (W)	2,539	3,041	2,576	1,891	1,996	2,175
ROE (%)	16.3	17.1	12.9	8.7	8.5	8.6
P/E (x)	10.3	12.6	13.0	17.0	16.1	14.8
P/B (x)	1.6	2.0	1.6	1.4	1.3	1.2

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

Table 1. 3Q15 preview (Wbn, %)

	3Q14	2Q15	3Q15F		Growth	
			KDB Daewoo	Consensus	YoY	QoQ
Revenue	692.5	646.8	705.6	706.0	1.9	9.1
Operating profit	32.6	24.2	35.8	33.8	9.8	47.9
Pretax profit	23.5	16.0	27.1	26.3	15.5	69.4
Net profit	16.4	11.7	21.2	20.1	29.4	80.9
OP margin	4.7	3.7	5.1	4.8	-	-
Net margin	2.4	1.8	3.0	2.8	-	-

Source: Company data, KDB Daewoo Securities Research

Table 2. Quarterly and annual earnings (Wbn, %)

	2015				2016F				2014	2015F	2016F
	1Q	2Q	3QF	4QF	1QF	2QF	3QF	4QF	Annual	Annual	Annual
Revenue	640	647	706	678	705	708	771	702	2,589	2,670	2,886
Operating profit	34	24	36	28	33	24	35	29	140	122	121
Pretax profit	28	16	27	19	27	19	28	20	114	90	93
Net profit	20	12	21	15	21	14	22	15	93	68	72
OP margin	5.3	3.7	5.1	4.2	4.7	3.4	4.5	4.1	5.4	4.6	4.2
Net margin	3.1	1.8	3.0	2.2	2.9	2.0	2.8	2.2	3.6	2.6	2.5
Revenue growth	3.7	1.0	1.9	6.1	10.2	9.5	9.2	3.6	1.8	3.2	8.1
OP growth	-22.1	-23.7	9.8	-12.4	-1.5	0.2	-3.1	0.1	-10.0	-12.8	-1.2
Pretax growth	-35.0	-47.9	15.5	12.5	-4.5	16.0	3.0	3.9	-18.4	-21.1	3.2
Net growth	-35.8	-53.9	29.4	-23.3	3.3	21.1	2.3	1.0	-15.3	-26.6	5.5

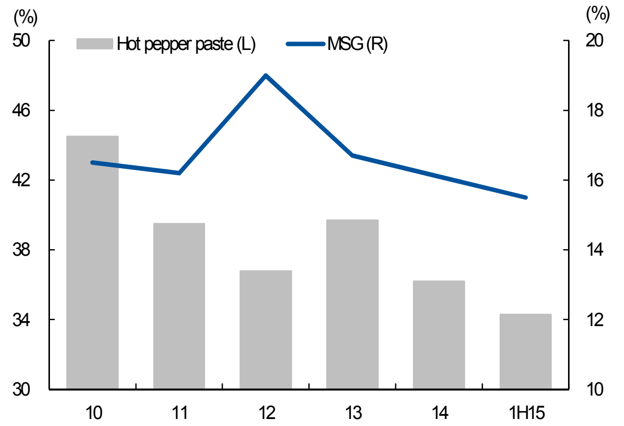
Source: Company data, KDB Daewoo Securities Research

Table 3. Earnings forecast revisions (Wbn, %)

	Previous		Revised		% chg.		Notes
	2015F	2016F	2015F	2016F	2015F	2016F	
Revenue	2,656	2,785	2,670	2,886	0.5	3.6	- Reflects lysine business acquisition
Operating profit	125	134	122	121	-2.1	-9.8	
Pretax profit	92	105	90	93	-2.3	-11.6	
Net profit	69	78	68	72	-1.3	-7.8	
OP margin	4.7	4.8	4.6	4.2	-	-	
Net margin	2.6	2.8	2.6	2.5	-	-	

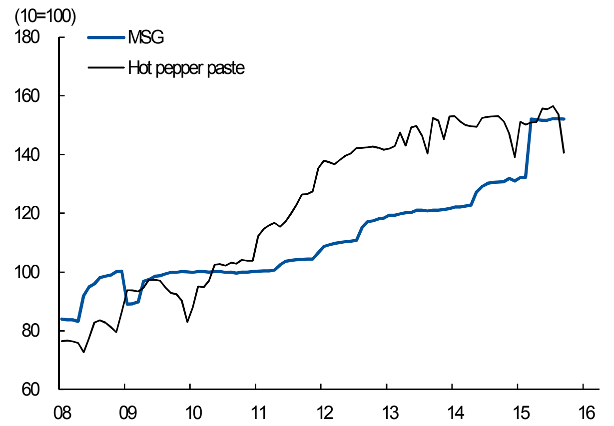
Source: Company data, KDB Daewoo Securities Research

Figure 1. Global hot pepper paste & MSG market share trends



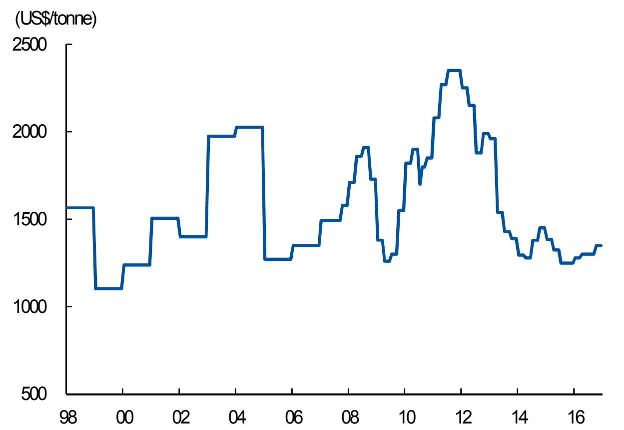
Source: Company data, KDB Daewoo Securities Research

Figure 2. Hot pepper paste & MSG shipment trends



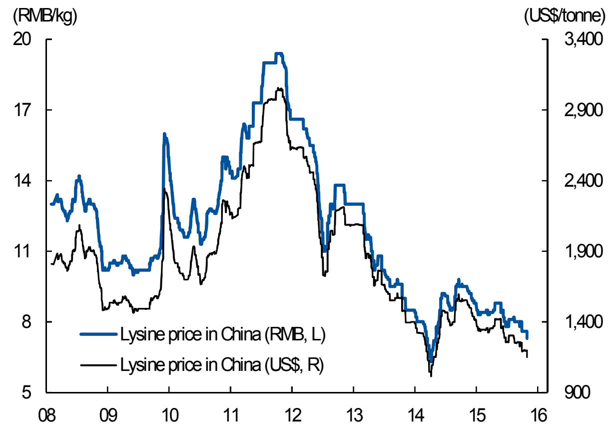
Source: KOSTAT, KDB Daewoo Securities Research

Figure 3. Global lysine price trend



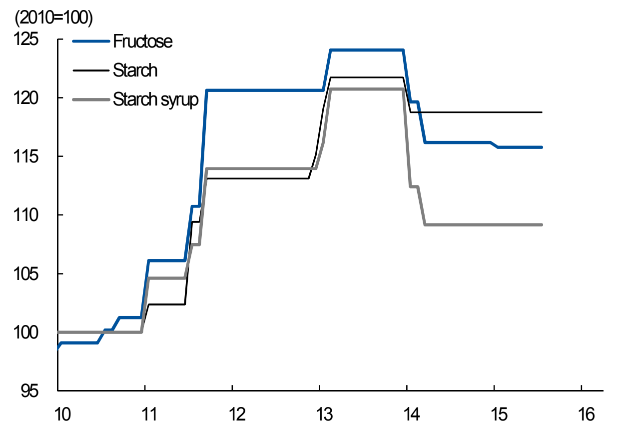
Source: Company data, KDB Daewoo Securities Research

Figure 4. Lysine price trend in China (spot)



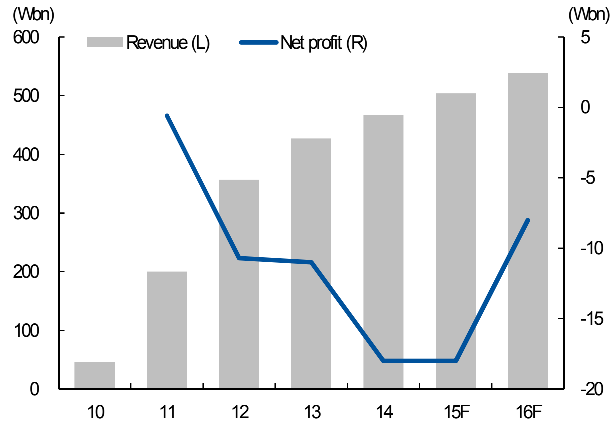
Source: China Feed. KDB Daewoo Securities Research

Figure 5. Starch sugar price trends



Source: KOSTAT, KDB Daewoo Securities Research

Figure 6. Daesang Bestco's earnings



Source: Company data, KDB Daewoo Securities Research

Daesang (001680 KS/Buy/TP: W50,000)

Comprehensive Income Statement (Summarized)

(Wbn)	12/14	12/15F	12/16F	12/17F
Revenue	**2,589**	**2,670**	**2,886**	**2,982**
Cost of Sales	**1,860**	**1,930**	**2,093**	**2,160**
Gross Profit	**729**	**740**	**793**	**822**
SG&A Expenses	**589**	**618**	**673**	**692**
Operating Profit (Adj)	**140**	**122**	**121**	**130**
Operating Profit	**140**	**122**	**121**	**130**
Non-Operating Profit	**-26**	**-32**	**-28**	**-23**
Net Financial Income	-12	-14	-12	-12
Net Gain from Inv in Associates	2	4	4	2
Pretax Profit	114	90	93	107
Income Tax	24	27	26	30
Profit from Continuing Operations	90	63	67	77
Profit from Discontinued Operations	0	0	0	0
Net Profit	90	63	67	77
Controlling Interests	93	68	72	78
Non-Controlling Interests	-3	-5	-5	-2
Total Comprehensive Profit	**77**	**60**	**67**	**77**
Controlling Interests	80	73	72	83
Non-Controlling Interests	-3	-13	-5	-6
EBITDA	203	188	191	205
FCF (Free Cash Flow)	55	7	33	38
EBITDA Margin (%)	7.8	7.0	6.6	6.9
Operating Profit Margin (%)	5.4	4.6	4.2	4.4
Net Profit Margin (%)	3.6	2.5	2.5	2.6

Statement of Financial Condition (Summarized)

(Wbn)	12/14	12/15F	12/16F	12/17F
Current Assets	**862**	**915**	**922**	**942**
Cash and Cash Equivalents	156	157	143	138
AR & Other Receivables	238	262	271	280
Inventories	243	258	261	269
Other Current Assets	225	238	247	255
Non-Current Assets	**953**	**1,031**	**1,116**	**1,156**
Investments in Associates	39	70	118	122
Property, Plant and Equipment	679	726	764	802
Intangible Assets	113	111	107	104
Total Assets	**1,815**	**1,946**	**2,038**	**2,099**
Current Liabilities	**569**	**727**	**739**	**729**
AP & Other Payables	222	236	244	252
Short-Term Financial Liabilities	272	413	413	393
Other Current Liabilities	75	78	82	84
Non-Current Liabilities	**461**	**385**	**409**	**413**
Long-Term Financial Liabilities	350	268	288	288
Other Non-Current Liabilities	111	117	121	125
Total Liabilities	**1,030**	**1,112**	**1,148**	**1,143**
Controlling Interests	**757**	**813**	**874**	**942**
Capital Stock	36	36	36	36
Capital Surplus	297	297	297	297
Retained Earnings	468	525	586	654
Non-Controlling Interests	**27**	**21**	**16**	**14**
Stockholders' Equity	**784**	**834**	**890**	**956**

Cash Flows (Summarized)

(Wbn)	12/14	12/15F	12/16F	12/17F
Cash Flows from Op Activities	163	109	138	148
Net Profit	90	63	67	77
Non-Cash Income and Expense	132	130	107	117
Depreciation	58	61	67	72
Amortization	5	5	4	3
Others	69	64	36	42
Chg in Working Capital	-15	-36	3	-3
Chg in AR & Other Receivables	-4	-24	-9	-8
Chg in Inventories	-13	-16	-3	-9
Chg in AP & Other Payables	17	-18	5	5
Income Tax Paid	**-33**	**-35**	**-26**	**-30**
Cash Flows from Inv Activities	-161	-122	-117	-120
Chg in PP&E	-103	-101	-105	-110
Chg in Intangible Assets	-4	0	0	0
Chg in Financial Assets	-51	-15	-10	-9
Others	**-3**	**-6**	**-2**	**-1**
Cash Flows from Fin Activities	-46	43	9	-31
Chg in Financial Liabilities	-36	57	20	-20
Chg in Equity	0	0	0	0
Dividends Paid	-5	-11	-11	-11
Others	**-5**	**-3**	**0**	**0**
Increase (Decrease) in Cash	-45	1	-14	-5
Beginning Balance	201	156	157	143
Ending Balance	**156**	**157**	**143**	**138**

Forecasts/Valuations (Summarized)

	12/14	12/15F	12/16F	12/17F
P/E (x)	13.0	17.0	16.1	14.8
P/CF (x)	5.4	6.0	6.7	6.0
P/B (x)	1.6	1.4	1.3	1.2
EV/EBITDA (x)	7.2	7.8	7.7	7.1
EPS (W)	2,576	1,891	1,996	2,175
CFPS (W)	6,173	5,353	4,814	5,369
BPS (W)	21,042	22,573	24,268	26,142
DPS (W)	300	300	300	300
Payout ratio (%)	11.5	16.5	15.5	13.4
Dividend Yield (%)	0.9	0.9	0.9	0.9
Revenue Growth (%)	1.8	3.1	8.1	3.3
EBITDA Growth (%)	-5.6	-7.4	1.6	7.3
Operating Profit Growth (%)	-10.3	-12.9	-0.8	7.4
EPS Growth (%)	-15.3	-26.6	5.6	9.0
Accounts Receivable Turnover (x)	11.7	11.3	11.5	11.4
Inventory Turnover (x)	10.9	10.7	11.1	11.3
Accounts Payable Turnover (x)	14.4	14.1	14.6	14.5
ROA (%)	5.1	3.3	3.4	3.7
ROE (%)	12.9	8.7	8.5	8.6
ROIC (%)	11.2	8.2	8.0	8.3
Liability to Equity Ratio (%)	131.3	133.4	129.0	119.6
Current Ratio (%)	151.5	125.8	124.8	129.2
Net Debt to Equity Ratio (%)	32.9	36.2	36.8	31.9
Interest Coverage Ratio (x)	6.1	5.4	5.8	6.3

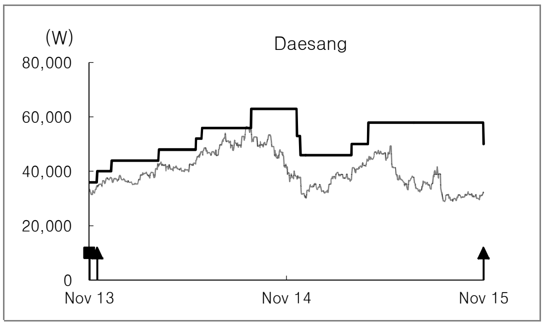
Source: Company data, KDB Daewoo Securities Research estimates

APPENDIX 1

Important Disclosures & Disclaimers

2-Year Rating and Target Price History

Company (Code)	Date	Rating	Target Price
Daesang (001680)	11/04/2015	Buy	50,000
	04/05/2015	Buy	58,000
	03/05/2015	Buy	50,000
	11/30/2014	Buy	46,000
	11/24/2014	Buy	53,000
	08/31/2014	Buy	63,000
	06/01/2014	Buy	56,000
	05/21/2014	Buy	52,000
	03/13/2014	Buy	48,000
	12/16/2013	Buy	44,000
	11/19/2013	Buy	40,000
	09/03/2013	Trading Buy	36,000



Stock Ratings	
Buy	: Relative performance of 20% or greater
Trading Buy	: Relative performance of 10% or greater, but with volatility
Hold	: Relative performance of -10% and 10%
Sell	: Relative performance of -10%

Industry Ratings	
Overweight	: Fundamentals are favorable or improving
Neutral	: Fundamentals are steady without any material changes
Underweight	: Fundamentals are unfavorable or worsening

Ratings and Target Price History (Share price (—), Target price (▬), Not covered (■), Buy (▲), Trading Buy (■), Hold (●), Sell (◆))
* Our investment rating is a guide to the relative return of the stock versus the market over the next 12 months.
* Although it is not part of the official ratings at Daewoo Securities, we may call a trading opportunity in case there is a technical or short-term material development.
* The target price was determined by the research analyst through valuation methods discussed in this report, in part based on the analyst's estimate of future earnings.
* The achievement of the target price may be impeded by risks related to the subject securities and companies, as well as general market and economic conditions.

Equity Ratings Distribution

Buy	Trading Buy	Hold	Sell
72.77%	13.86%	13.37%	0.00%

* Based on recommendations in the last 12-months (as of September 30, 2015)

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