

# Shinjin SM

(138070 KQ)

## At the forefront of the metal plate industry

### Machinery

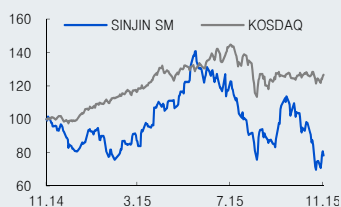
#### Initiation Report

November 23, 2015

(Initiate)	<b>Buy</b>
Target Price (12M, W)	<b>25,000</b>
Share Price (11/20/15, W)	17,600
Expected Return	42%

OP (15F, Wbn)	7
Consensus OP (15F, Wbn)	10
EPS Growth (15F, %)	-22.4
Market EPS Growth (15F, %)	21.0
P/E (15F, x)	37.1
Market P/E (15F, x)	11.5
KOSDAQ	685.16
Market Cap (Wbn)	158
Shares Outstanding (mn)	9
Free Float (%)	46.6
Foreign Ownership (%)	0.5
Beta (12M)	0.89
52-Week Low	15,650
52-Week High	31,600

(%)	1M	6M	12M
Absolute	-22.6	-35.3	-21.1
Relative	-22.0	-32.6	-37.8



Daewoo Securities Co., Ltd.

[Shipbuilding & Machinery]

Ki-jong Sung

+822-768-3263

kijong.sung@dwsec.com

Ho-seung Lee

+822-768-4176

hoseung.lee@dwsec.com

### A metal plate and cutting machine manufacturer

Shinjin SM was established in 1991 as an automated machinery manufacturer. The company transitioned into a standardized plate manufacturer after developing a steel sheet cutting machine in 2001. More recently, the company has broadened its business scope to include large-sized plates, developing a large-sized plate cutting machine in 2014 and setting up subsidiary Shinjin ESCO in 2015. The company has overseas subsidiaries in Thailand and Japan, and plans to branch out into China and Indonesia.

Shinjin SM's standardized plate production technology has a number of advantages over other manufacturing techniques. The company uses a circular saw (instead of oxygen-based cutting), which eliminates the need for post-processing and significantly shortens the entire manufacturing process. In addition to labor cost savings, the company's production method allows for leaner inventory and quicker delivery, which are positive to profit margins.

### Moving beyond standardized plates and into cutting machines

After building a successful presence in the small-sized plate market, Shinjin SM is now moving into the large-sized plate segment. The company is also looking to sell plate cutting machines.

1) Small-sized plates: In Korea, Shinjin SM has 33 distribution partners (which produce plates using long products and machines purchased from the company) and is adding one or two more annually, which should help drive market share gains.

2) Large-sized plates: In 2015, the company established subsidiary Shinjin ESCO to expand into the large-sized plate market. While the business is in the very early stages and has yet to show meaningful results, we believe earnings will gradually improve, supported by the utilization improvement of both new and existing distributors. In our view, large-sized plates are the company's biggest growth driver. The large-sized plate market has a wide range of downstream industries (including molding and press) which differ from those of small-sized plates (which are mostly used for machine parts).

3) Plate cutting machines: The company is also getting ready to sell small-sized plate cutting machines ahead of the expiration of key patents. The commercialization of the company's unique technology should provide a huge boost to margins. The move will not affect the company's long steel sales, as the company plans to hold onto its long steel producing technology and sell only its small plate cutting machines.

### Initiate coverage with Buy and TP of W25,000

We initiate our coverage on Shinjin SM with a Buy rating and target price of W25,000. We derived our target price by applying to our 2016F EPS of W1,195 a P/E of 21x, the weighted average multiple of 1) machinery parts suppliers, 2) companies with similarly strong market positions, and 3) players with comparable growth potential. Even during economic slowdowns, we believe Shinjin SM will yield ROE of over 20% and increase its market share on the back of its sound balance sheet and robust competitiveness. Furthermore, we see ample room for long-term growth given the company's domestic and overseas expansion, and expect stable cash flow generation.

FY (Dec.)	12/12	12/13	12/14	12/15F	12/16F	12/17F
Revenue (Wbn)	39	41	48	60	81	101
OP (Wbn)	8	5	6	7	13	18
OP margin (%)	20.5	12.2	12.5	11.7	16.0	17.8
NP (Wbn)	8	5	5	4	11	16
EPS (W)	839	513	611	474	1,195	1,728
ROE (%)	14.7	8.5	9.5	6.9	15.8	19.3
P/E (x)	9.6	39.6	29.8	37.1	14.7	10.2
P/B (x)	1.4	3.3	2.7	2.5	2.2	1.8

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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# I. Investment points

## 1. Delivering innovation to the plate business

We believe that Shinjin SM's steel sheet cutting technology boasts top-tier competitiveness. Compared to oxygen-based cutting, it yields a significantly shorter manufacturing process (leading to cost savings). Notably, Shinjin SM's small-sized plate market share has expanded to more than 10% over the last decade. Given the company's expansion into the large-sized plate segment in 2015, we expect the company will become a dominant player in the overall plate market in the coming years.

## 2. Small-sized plate market share gains → rosy long-term growth prospects

Capitalizing on its stellar cutting technology, Shinjin SM has displayed brisk growth in the small-sized standardized plate market. In Korea, the company is adding one or two distribution partners (including directly-operated distributors) annually. We expect the company's partner count to increase from 33 in 2015 to 35 in 2016. Shinjin SM's annual revenue per partner (on average) is around ₩1.5-2bn.

## 3. Expansion into large-sized plates → new growth engine

In 2015, Shinjin SM expanded into the large-sized plate market on the back of its know-how in small-sized plates. We expect the large-sized plate business to serve as a growth driver for the company in the future. Shinjin SM established subsidiary Shinjin ESCO (annual production of roughly ₩60bn), which launched a new facility in 2Q. Generally speaking, it takes roughly nine months for operations at a new factory to normalize. Thus, although Shinjin ESCO's facility incurred losses in 2Q-3Q15, it is anticipated to swing to black in 4Q15 on the back of growing orders and improving productivity.

In particular, the large-sized plate market is bigger than the small-sized segment. And the consumable molding segment accounts for a big portion of the market. Given Shinjin SM's strong cutting machine technology, quick delivery, and quality products, we expect market share to grow quickly.

## 4. Full-swing sales of plate cutting machines → margin expansion

Shinjin SM possesses patents for a variety of cutting technologies, including machines for cutting sheets up to 250mm thick. In addition to selling small-sized cutting machines (sheets up to 75mm thick), for which key patents are expiring, the company plans to pursue full-swing commercialization of machines capable of cutting up to 250mm sheets as a key item for 2016. Given the high margins of the product, we expect the company's earnings to receive a boost.

## 5. Overseas expansion → medium- to long-term strategy

In an attempt to overcome domestic market limitations, Shinjin SM is expanding overseas as part of its medium- to long-term growth strategy. The company established a production subsidiary in Thailand (in 2012) and also built a distribution subsidiary in Japan. In Thailand, revenue in areas in which the auto parts industry is booming is likely to grow steadily. We expect that Thailand operations will suffer an operating loss of ₩7bn in 2015, but swing to an operating profit in 2016 on revenue of approximately ₩10bn.

Also, the company plans to branch out into other Asian nations, such as China and Indonesia (which is seeing growing manufacturing demand). The company has considered this expansion for several years. It is unclear whether Shinjin SM will pursue entry into China in partnership with a local company or on its own. With regard to Indonesia, expansion could prove easy given that POSCO has a steel plate facility there.

## II. Corporate overview

### 1. Overview

#### 1) Specialist in plates boasting superior steel sheet cutting technology

Shinjin SM produces standardized plates by cutting steel sheets (e.g., heavy plates, slab, and specialty steel). Machinery makers use these plates to produce key machine parts and other products.

Shinjin SM was established in 1991 as an automated machinery manufacturer. The company transitioned into a standardized plate manufacturer in 2001 after developing a circular saw-based cutting technology and established a factory in Jangsu in 2005. Shinjin SM, which was listed on the KOSDAQ in November 2011, has broadened its business portfolio to include large-sized plates, developing a large-sized plate cutting machine in 2014 and setting up Shinjin ESCO in 2015 in partnership with POSCO. Shinjin ESCO commenced operations in April 2015.

#### \* What is a standardized plate?

Standardized plates have stronger cost competitiveness than ordinary plates. After producing long steel (bar type) from large-sized heavy plates, makers manufacture rectangular parallelepiped-shaped plates. Costs of standardized plates are more than 20% lower than those of ordinary plates.

### 2. Ownership structure and subsidiaries

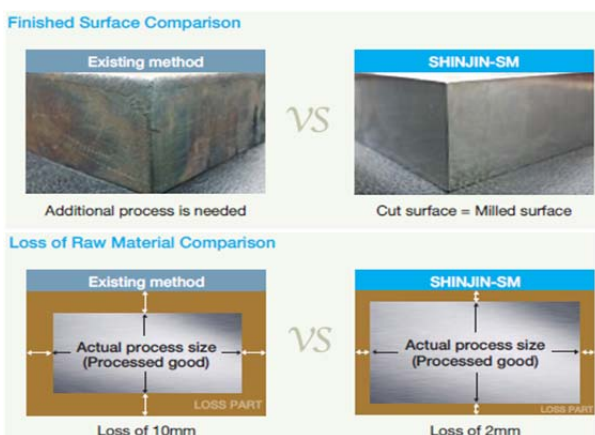
#### 1) Ownership structure

Chairman Kim Young-hyun holds a 33.64% stake in Shinjin SM. Major shareholders and related parties possess 52.98% (including the stake owned by Kim). Mirae Asset Global Investments holds a 13.8% stake, while foreign ownership stands at 0.44%.

#### 2) Subsidiaries

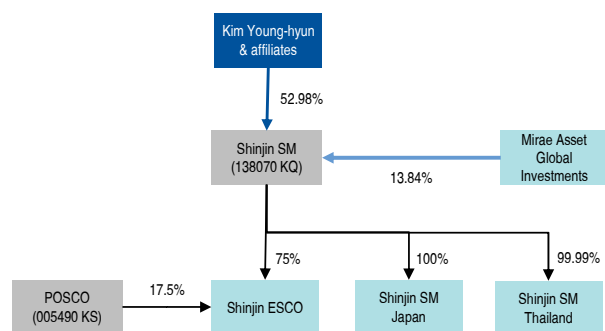
Shinjin SM's subsidiaries include Shinjin ESCO (domestic) and companies in Thailand and Japan. Shinjin ESCO is owned by Shinjin SM (75%), POSCO (17.5%), and other players (7.5%). The overseas subsidiaries in Thailand and Japan are wholly owned by Shinjin SM.

Figure 1. Standardized plate



Source: Company data, KDB Daewoo Securities Research

Figure 2. Ownership structure (including subsidiaries)



Source: Company data, KDB Daewoo Securities Research

### III. Issues

#### Competitive landscape

Shinjin SM's largest competitor with regard to cutting technology is Seoungwa ST (unlisted), which also produces standardized plates using circular saw-based machines. The company has 28 distribution partners and boasts a market strategy similar to Shinjin SM's. Major differences are as follows.

1) Circular saw-based cutting technology: The development of Seoungwa ST's cutting technology was constrained by Shinjin SM's patents. Although Seoungwa ST's equipment features a relatively uneven cutting plane, it is still able to yield quality products through the use of other technologies. Shinjin SM has 25 patents (including 14 circular saw and cutting technologies). Meanwhile, Seoungwa ST has five patents related to processing (e.g., milling, calibration error correction, and bifacial process).

2) Distribution partners: Shinjin SM has 33 distributors (including two directly-operated ones), while Seoungwa ST has 28 distributors (including multiple directly-operated ones).

3) Growth potential: Shinjin SM's revenue has shown a CAGR of 16%, while Seoungwa ST's revenue has displayed 11% growth. Shinjin SM is pursuing top-line growth and market share expansion, while Seoungwa ST is focused on margin improvement.

4) Profitability: Shinjin SM generated an average OP margin of 12.3% over the past two years, while Seoungwa ST recorded an average margin of 32%. This gap seems attributable to depreciation, differences in direct distribution, and raw material costs. In particular, Shinjin SM emphasizes the input of quality heavy plates (produced by POSCO), while Seoungwa ST uses Chinese heavy plates.

Table 1. Comparison of patents held Shinjin SM and Seoungwa ST

	Shinjin SM	Seoungwa ST
Total patents	25	5
<b>Related to cutting machines</b>	<b>14</b>	<b>0</b>
Related to other equipment	5	5
Related to parts	6	0
Main patents	Wedge for separating steel sheet sections	Bifacial process for standardized plates; technologies related to correcting plate twisting and calibration errors

Source: DART, KDB Daewoo Securities Research

Table 2. Shinjin SM vs. Seoungwa ST

(Wmn, %)

	2013		2014	
	Shinjin SM	Seoungwa ST	Shinjin SM	Seoungwa ST
Revenue	40,808	17,197	47,794	19,434
Operating profit	5,034	4,617	5,834	7,348
<i>OP margin</i>	<i>12.3</i>	<i>26.8</i>	<i>12.2</i>	<i>37.8</i>
Net profit	4,605	3,177	5,481	4,877
Gross margin	24.1	32.9	23.3	45.3
Debt ratio	23.7	99.2	47.2	68.6
Current ratio	294.5	145.4	250.3	243.3
Interest coverage ratio (x)	19	84	21	134
No. of employees	-	-	-	-
Distributors	37	-	41	28
Establishment	-	-	July 2001	July 2007

Note: Based on disclosed data

Source: DART, KDB Daewoo Securities Research

## IV. Plate market outlook

### 1. Types and usage

#### 1) Small-sized

Shinjin SM's standardized plates with thickness of 75mm and below are classified as small-sized. Small-sized plates are generally used in cars, semiconductor equipment, and general machinery

#### 2) Large-sized

Large-size plates, which are at least 75mm thick, are used in mold bases, machine presses, plants, vessels, and bases for large equipment. Since the company developed a 250mm plate cutting machine in July 2014, demand from shipbuilders and steelmakers has been on the rise. Of note, this new cutting machine is expected to replace demand for cutting machines for heavy plates and slabs with thickness of 200mm or over. Accordingly, demand from shipbuilders and plant equipment producers will likely increase going forward.

Figure 3. Small-sized plate market

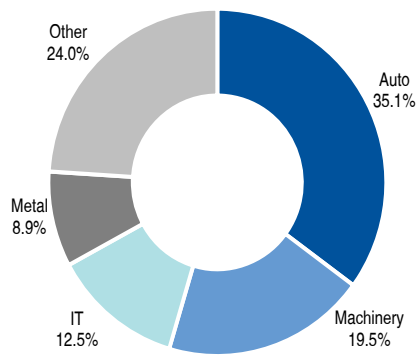
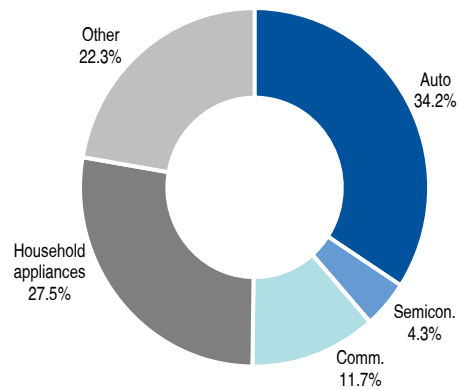


Figure 4. Large-sized plate market



Source: Komma, KDB Daewoo Securities Research

Source: Kitech, KDB Daewoo Securities Research

Figure 5. Plate products



Source: Company data, KDB Daewoo Securities Research

## 2. Standardized plate market outlook

### 1) Standardized plate market estimated at W1.3tr based on heavy plate consumption

As standardized plates are made of heavy plates, heavy plate consumption levels should help us to estimate the value of the standardized plate market. Heavy plates are mostly produced from carbon steel. Thus, we excluded specialty steel-based sheets from our assumptions.

The nominal consumption of heavy plates can largely be broken down into shipbuilding, construction, general machinery, and other applications. In calculating total plate-use heavy plate consumption, we excluded consumption by shipbuilders and combined the volumes of heavy plates used for general machinery and other applications. In addition, we assumed the percentage of heavy plates in construction plant components at 20%. Then, we applied assumptions for SG&A ratio and processing and sales margins (including margins for distribution partners) to our heavy plate consumption estimate. This yielded a total standardized plate market estimate of W1.3tr.

### 2) Large-size plate market estimated at W2tr extrapolating from mold market metrics

According to Statistics Korea, the mold market has been grown at an average annual rate of 7-8% and exceeded W8tr in 2013. Mold bases are produced by cutting large-sized heavy plates and treating them with heat. Given that large-sized plates account for 30-40% of mold base production costs, the use of large-sized plates, including imports, is estimated at W1.5-2tr.

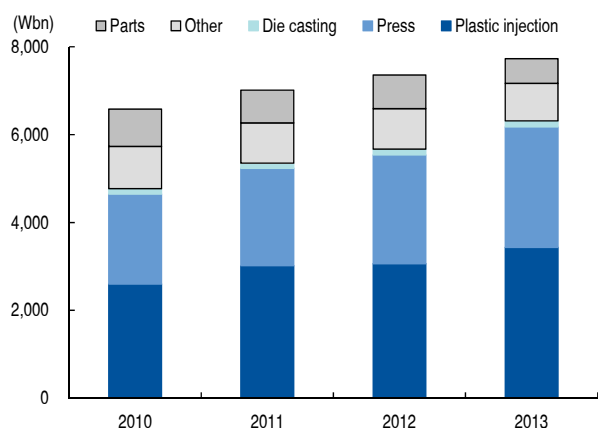
Factoring in demand from the machinery and plant markets, the large-sized standardized plate market is projected at around W2tr, which is significantly higher than our market estimate based on heavy plate consumption. The gap between the estimates indicates that processing and sales margins could be higher than our assumption, or the use of large-sized plates in construction plants could be larger than our projection.

Table 3. Plate market estimates

		(tonnes, Wbn, W)			
Type		2012	2013	2014	2015F
<b>Nominal consumption</b>	<b>(tonnes)</b>	<b>11,293,327</b>	<b>9,093,720</b>	<b>10,546,912</b>	<b>10,500,000</b>
A. Shipbuilding (excluded)	(tonnes)	8,582,929	6,638,416	7,382,838	6,825,000
B. Construction (partially included)	(tonnes)	1,919,866	1,545,932	1,898,444	2,100,000
C. General machinery (included)	(tonnes)	677,600	727,498	1,054,691	1,050,000
D. Other (partially included)	(tonnes)	112,933	181,874	210,938	525,000
E. Heavy plate price	(W)	810,000	711,000	617,000	485,000
<b>F. Plate market (est.)</b>	<b>(B*0.2+C+D)*E (Wbn)</b>	<b>796</b>	<b>756</b>	<b>898</b>	<b>866</b>
Processing and sales costs	G. SG&A (incl. depreciation)	14%	16%	15%	15%
	H. Processing margin (Shinjin SM)	27%	16%	17%	20%
	I. Sales margin (distributor)	20%	20%	20%	20%
<b>Total plate market</b>	<b>F*(1+G+H+I) (Wbn)</b>	<b>1,282</b>	<b>1,148</b>	<b>1,361</b>	<b>1,340</b>

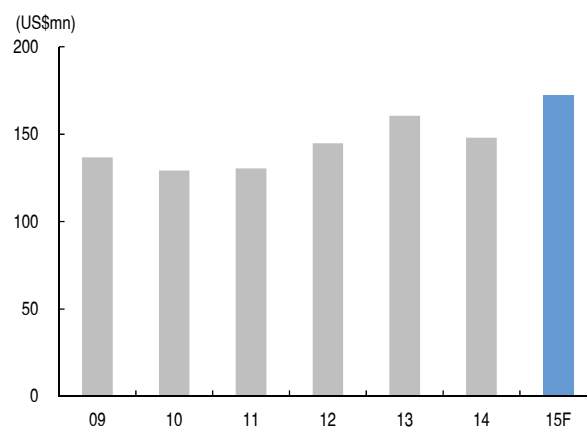
Source: Steeldaily, KDB Daewoo Securities Research

Figure 6. Domestic mold production



Source: KOSTAT, KDB Daewoo Securities Research

Figure 7. Domestic mold imports

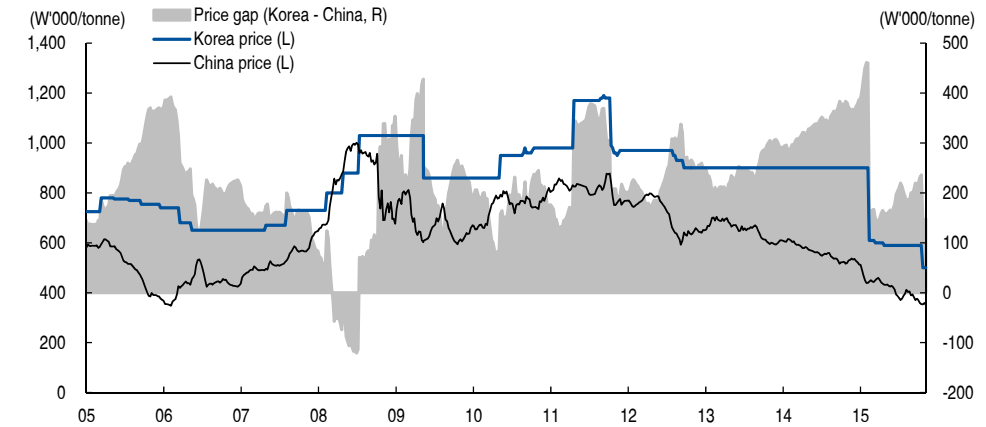


Source: KOSTAT, KDB Daewoo Securities Research

### 3) 2016 market outlook

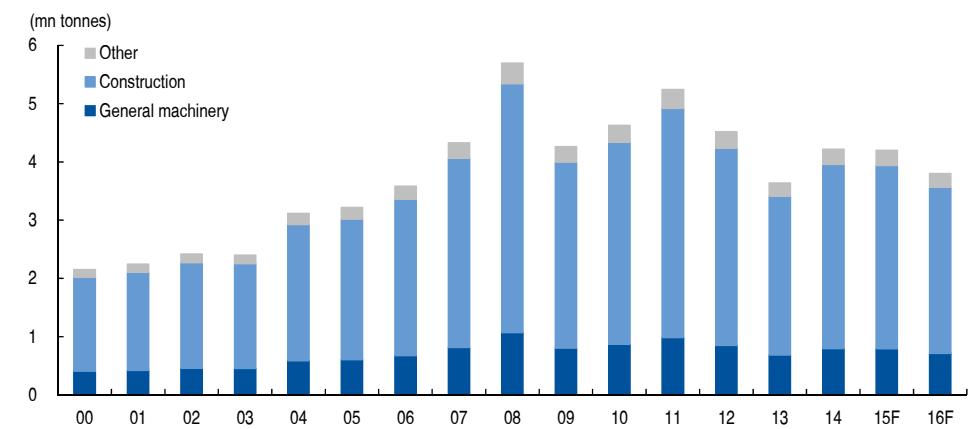
Heavy plate prices will likely fall further in 2016 amid economic slowdown. However, the degree of decline is not anticipated to exceed 5%, as a fall in excess of that level should lead to losses at steelmakers. Accordingly, the downtrend in heavy plate prices should have only a limited impact on the plate market. However, demand for heavy and standardized plates is not expected to increase significantly due to by sluggish economic conditions. In fact, the overall plate market is projected to contract by around 5% in 2016.

**Figure 8. Chinese heavy plate price vs. Korean heavy plate price**



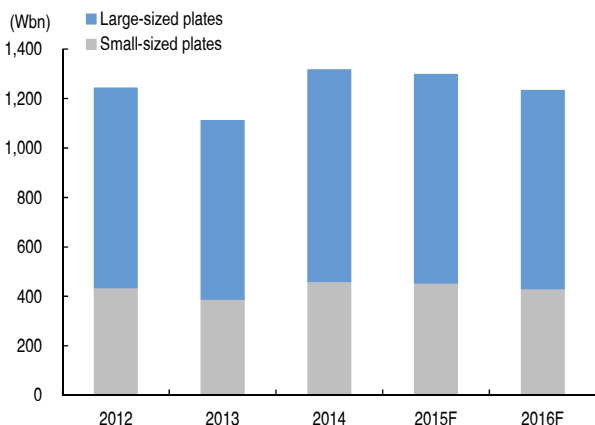
Source: Steel Daily, Bloomberg, KDB Daewoo Securities Research

**Figure 9. Domestic heavy plate consumption**



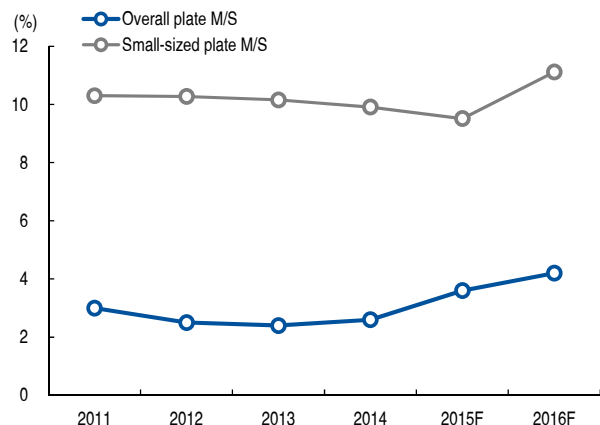
Source: Steel Daily, KDB Daewoo Securities Research

**Figure 10. Domestic plate market**



Source: Steel Daily, KDB Daewoo Securities Research

**Figure 11. Shinjin SM's share of the total plate market**



Source: Steel Daily, KDB Daewoo Securities Research

## V. Standardized plate business analysis

### 1. Small-sized plates

#### 1) Development of circular saw-based cutting machines

Shinjin SM launched its standardized plate business in the early 2000s after developing a circular saw-based cutting machine.

Among existing technologies, oxygen-based cutting is the most widely used due to its low costs. However, as this technology requires additional processes, including milling and deoxidization, Shinjin SM's circular saw-based cutting machines are more efficient. Indeed, Shinjin SM's proprietary technologies allow for the simplification of manufacturing and reduced processing times.

Shinjin SM's competitiveness in cutting machines has helped fuel market share gains <Figure 11>. The company is estimated to account for 12% of the domestic small-sized plate market and 4% of the domestic plate market.

#### 2) Distribution network expansion

Shinjin SM has established a nationwide distribution network for plate sales. The company sells long steel and cutting machines to its distribution partners, which in turn produce and sell plates.

Shinjin SM has been adding one or two distribution partners to its network each year after strict screening. To make inroads into the large-sized plate market, the company established Shinjin ESCO (which is also partially owned by POSCO), in 2015. Shinjin SM plans to secure four partners for the distribution of large-sized plates this year and steadily expand its distribution network.

Shinjin SM has steadily added distribution partners regardless of market conditions, which has led to revenue and market share growth. Monthly average revenue at each partner is estimated at W0.15-0.2bn.

Figure 12. Oxygen-based cutting machines vs. circular saw-based cutting machines

	Materials	Cutting	Grinding	Calibration	Quality control
Oxygen-based cutting machines				Necessary	
Circular saw cutting machines			Unnecessary		

Source: Company data, KDB Daewoo Securities Research

**Table 4. Shinjin SM's patents**

Patent	Registration	Usage
Circular saw blade assembly for cutting machines	2004	- Precision and high-speed cutting
Separation apparatus (wedge)	2005	- Mass production
Circular saw-based cutter	2006	- High-speed cutting
Cutter assembly for surface milling and milling machine	2010	- Shorter processing time

Source: Company materials, Korean Intellectual Property Office, KDB Daewoo Securities Research

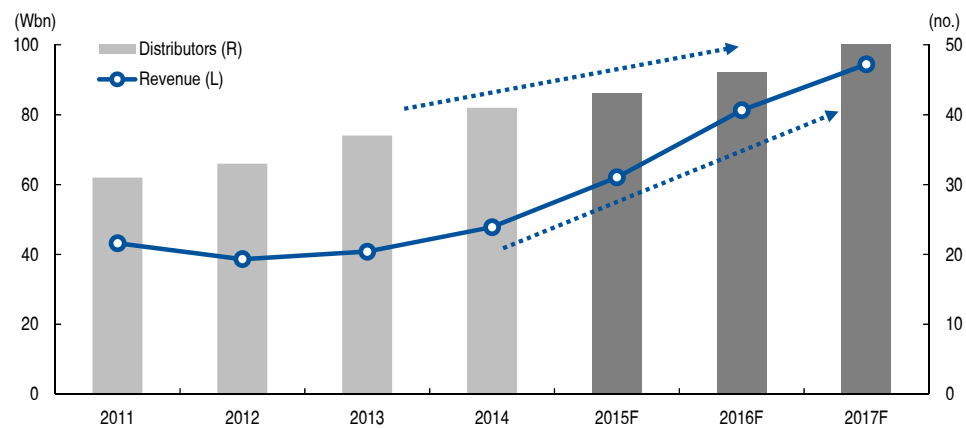
**Table 5. Production capacity**

(Wbn)

Company	Region	Products	Production capacity	
Shinjin SM	Jangsu	Standardized plates	35	
	Jungnam	Standardized plates	20	
	Dongtan	Secondary products	5	
	Balan	Wide plates	5	
Shinjin ESC)	Jungnam	Large-sized plates	60	Started operating in April 2015
Shinjin Japan	Tokyo, Osaka	Standardized plates	3	
Shinjin Thailand	Rayong	Standardized plates	23	Product diversification
Total			151	

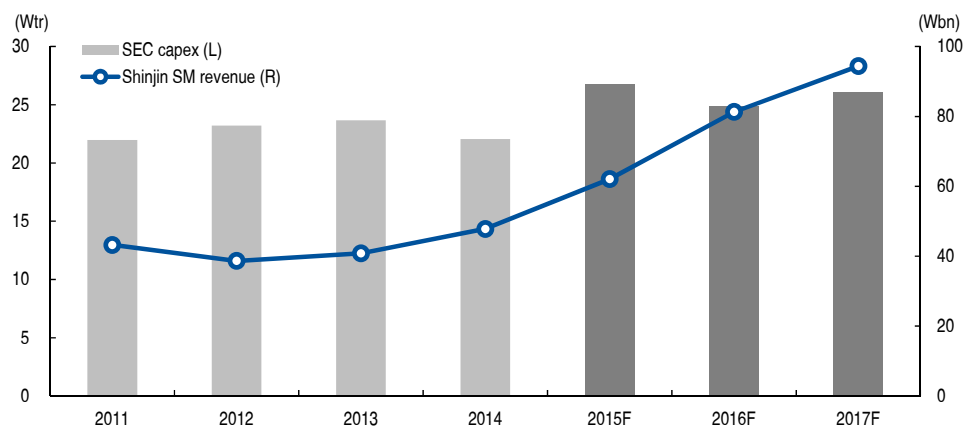
Source: Company data, KDB Daewoo Securities Research

**Figure 13. Number of distributors and revenue**



Source: Company data, KDB Daewoo Securities Research

**Figure 14. SEC capex and Shinjin SM revenue**



Source: Company data, KDB Daewoo Securities Research

## 2. Shinjin ESCO

### 1) Going bigger with Shinjin ESCO

After becoming Korea’s largest producer of small-sized plates, Shinjin SM established Shinjin ESCO in November 2014 with the aim of expanding into the large-sized plate market. Shinjin SM supplied 200mm plate cutting machines (developed in 2013 in partnership with POSCO) to the subsidiary, which commenced operations in April of this year. Shinjin ESCO is 75% owned by Shinjin SM, and 17.5% by POSCO.

### 2) Business portfolio and customer diversification

Because the demand for large- and small-sized plates comes from different sources, Shinjin ESCO will not be able to significantly tap into Shinjin SM’s customer base. However, Shinjin ESCO should still be able to leverage its parent company’s substantial know-how.

Shinjin ESCO is expected to partner with four distributors before the end of the year (two confirmed, two expected), with more to come next year. Given the firm’s steady customer acquisition on the back of timely delivery and quality products, the company’s earnings are likely to turn around beginning in 4Q15.

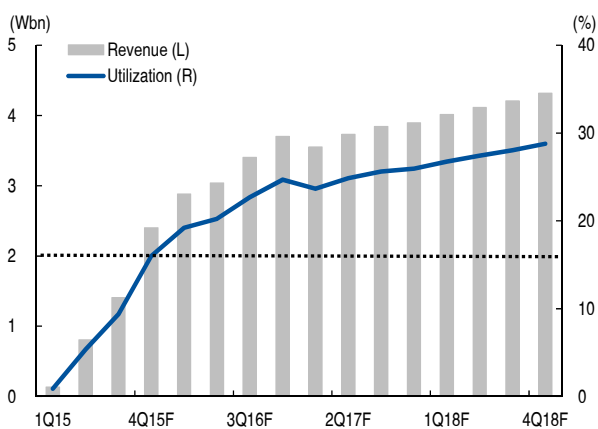
While demand for small-sized plates mostly comes from the auto, machinery, and semiconductor equipment markets, large-sized products are generally used in the steel, shipbuilding, molding, machine press, and plant part segments. Of note, although domestic molding production has already reached a whopping W8tr, the segment still has good growth prospects, given the potential domestic production of mold bases (vs. current reliance on imports).

### 3) Rising utilization

Generally, it takes roughly one year for the yield of new production facilities to normalize (including the time required for workers to get accustomed to new machinery and operational normalization). For Shinjin ESCO, however, the period will likely be shorter, as the parent company has already learned through significant trial and error both at home and abroad. Still, a conservative valuation will be necessary, as the large-sized plate market is quite different from the small-sized one.

We believe that quarterly revenue of W2bn represents the break-even level for Shinjin ESCO. The firm reported losses over the past two quarters (2Q and 3Q) due to lackluster revenue, but should turn to profit in 4Q, aided by increased orders and greater utilization (resulting from higher productivity). The company, which has annual production capacity of W60bn, is expected to boost Shinjin SM’s consolidated earnings sharply beginning next year.

Figure 15. Shinjin ESCO’s revenue and utilization



Source: Company data, KDB Daewoo Securities Research

Figure 16. Distribution network plans



Source: Company data, KDB Daewoo Securities Research

### 3. Increased sales of plate cutting machines

Ahead of the expiry of its patents, Shinjin SM plans to increase the sales of its circular saw-based plate cutting machines. To this end, it will begin to supply small-sized and some mid/large-sized plate cutting machines to existing distribution partners. Previously, supply of small-sized plate cutting machines was limited to newly-opening distributors. Supply of large-sized plate cutters has also been limited to only a handful of steelmakers.

Small-sized cutters are used to produce plates up to 30cm long and 75mm thick, and mid-sized machines yield plates up to 6m in length, and 250mm thick. The company will continue to keep its long steel producing machines at its headquarters, and supply long steel products to distribution partners and other players.

Small-sized cutters sell for as much as W200 million, while large-sized ones sell for around W1bn per unit. Shinjin SM sold three large-sized cutting machines developed last year to Daesung Steel (a partner of POSCO) for W3.3bn, and three more orders were received in June. As large-sized cutting machines are being sold to Shinjin ESCO's distribution partners, increased sales are likely to boost profitability going forward.

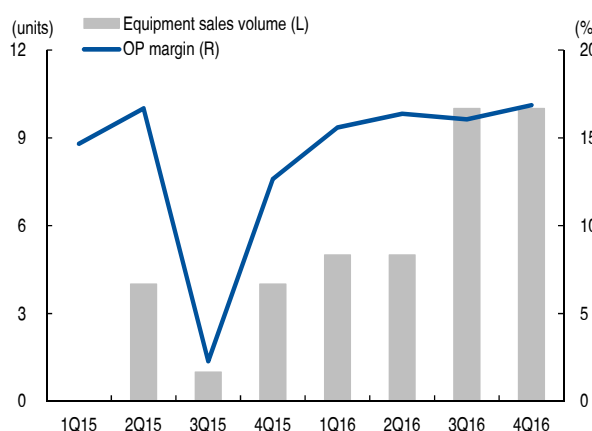
### 4. Overseas expansion

Shinjin SM established its first overseas plate distribution subsidiary in Japan in 2009. Since then, it has extended its reach to Singapore and Thailand (production subsidiary). Last year, large-sized cutting machines were installed in the Thailand facilities, giving the subsidiary the capability to manage the production process from beginning to end. Despite their large-scale facilities, Shinjin SM's recently established overseas subsidiaries are likely to report losses this year due to low revenue.

Thailand is strategically important for Shinjin SM, as the country is home to several global auto parts makers (Japanese, etc.). In particular, establishing a solid reputation with Japanese customers will make it easier to forge business relationships with other players. The Thai subsidiary is the biggest contributor to Shinjin SM's overseas revenue, despite its relatively recent launch. Inventory losses were large in 2015 due to falling heavy plate prices, but a turnaround is expected next year in light of inventory clearance, increased marketing efforts, and productivity improvement.

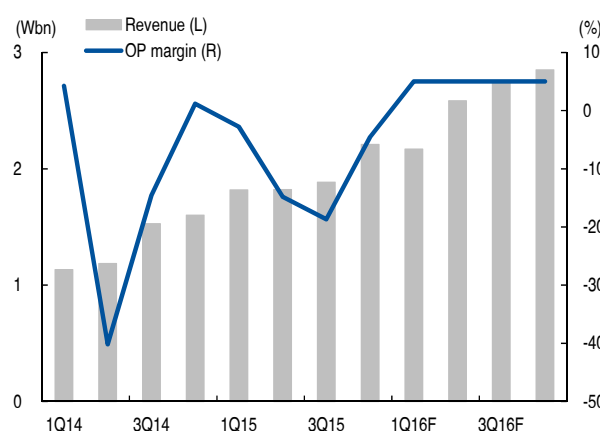
Looking ahead, Shinjin SM will likely expand into Indonesia and China. POSCO has a heavy plate production factory in Indonesia, and other global steelmakers are expanding operations in these two countries. China is the world's largest manufacturing base, the biggest consumer of steel plates, and a large supplier of heavy plates. We believe that Shinjin SM's plate cutting machines, combined with cheap local heavy plate, will lead to cost-competitive Chinese operations.

Figure 17. Equipment sales volume and OP margin



Source: Company data, KDB Daewoo Securities Research

Figure 18. Overseas earnings



Source: Company data, KDB Daewoo Securities Research

## VI. Earnings and forecasts

### 3Q15 review: Revenue of W13.5bn (-3.3% YoY) and OP of W0.3bn (-84% YoY)

For 3Q15, Shinjin SM posted consolidated revenue of W13.5bn (-3.3% YoY) and operating profit of W0.3bn (-84% YoY). OP margin came in at 2.3%, falling below the consensus.

The weak operating profit is attributable to 1) poor subsidiary earnings and 2) lower ASP arising from the decline in heavy plate prices. However, the domestic subsidiary Shinjin ESCO has high growth potential, given that its revenue grew QoQ, and net losses at the Thailand subsidiary can mainly be ascribed to one-off expenses.

Under non-consolidated K-IFRS, Shinjin SM recorded revenue of W11bn (-14% YoY). Although small-sized plate revenue expanded, overall revenue contracted on lower heavy plate prices. In addition, revenue growth was weak due to the sale of only one cutting machine, driving down profitability both YoY and QoQ.

### 2015 outlook: Revenue of W60.5bn (+26.5% YoY) and OP of W7.2bn (+24% YoY)

For 2015, we forecast Shinjin SM to post revenue of W60.5bn (+26.5% YoY), operating profit of W7.2bn (+24% YoY), and an OP margin of 12%.

Although overall revenue has increased thanks to the launch of operations at Shinjin ESCO in 2Q, the domestic subsidiary has posted losses for two straight quarters, denting profitability. In 4Q, however, the subsidiary will likely swing to a profit, buoyed by an increase in cutting machine sales arising from customer base growth and new distribution partners. Overseas subsidiary earnings, which remained in negative territory until 3Q, are likely to reach a break-even point in 4Q, contributing to profitability improvement. Furthermore, parent-based sales volume will likely grow steadily.

### 2016 outlook: Revenue of W80.8bn (+33.6% YoY) and OP of W13.1bn (+81% YoY)

In 2016, we expect Shinjin SM to continue to grow despite economic uncertainties, as 1) revenue at Shinjin ESCO will likely rise on sales network expansion; 2) parent-based revenue and profit should increase on market share gains and cutting machine business expansion; and 3) overseas subsidiaries should swing to profit.

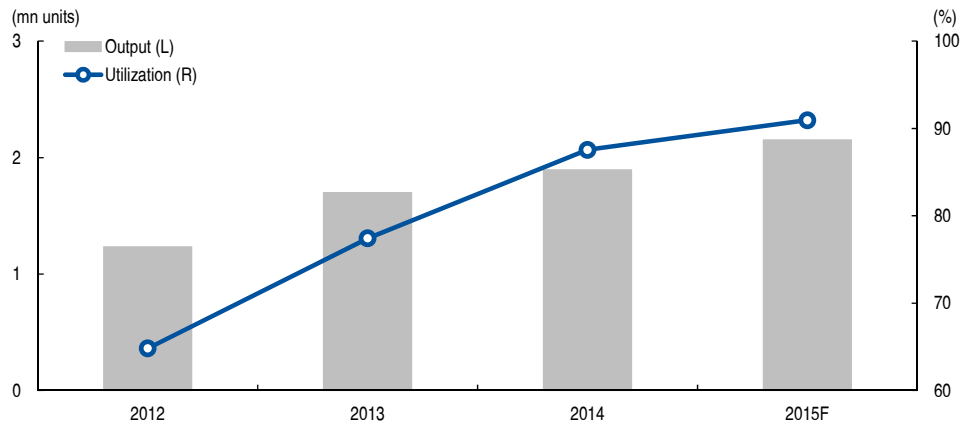
Table 6. Shinjin SM's earnings

(Wbn, %)

	1Q14	2Q14	3Q14	4Q14	1Q15	2Q15	3Q15	4Q15F	1Q16F	2Q16F	3Q16F	4Q16F	2014	2015F	2016F
<b>Revenue (consolidated)</b>	<b>11.1</b>	<b>11.1</b>	<b>14.0</b>	<b>11.6</b>	<b>12.2</b>	<b>17.8</b>	<b>13.5</b>	<b>17.0</b>	<b>18.7</b>	<b>19.8</b>	<b>20.8</b>	<b>21.5</b>	<b>48</b>	<b>60</b>	<b>81</b>
Parent	11.2	11.3	12.8	10.3	10.3	10.8	10.2	11.9	11.4	11.6	12.4	12.5	46	43	48
Shinjin ESCO	-	-	-	-	0.1	0.8	1.4	2.4	3.1	3.6	4.0	4.6	0	5	15
Cutting machines	-	-	-	-	-	4.4	0.8	0.5	2.0	2.0	1.6	1.6	0	6	7
Overseas subsidiaries	1.1	1.2	1.5	1.6	1.8	1.8	1.9	2.2	2.2	2.6	2.8	2.9	5	8	10
Revenue adj.	-1.2	-1.4	-0.3	-0.3	-0.1	0.0	-0.7	0.0	0.0	0.0	0.0	0.0	-3	-1	0
<b>Operating profit</b>	<b>1.4</b>	<b>1.1</b>	<b>2.0</b>	<b>1.5</b>	<b>1.8</b>	<b>3.0</b>	<b>0.3</b>	<b>2.2</b>	<b>3.0</b>	<b>3.4</b>	<b>3.3</b>	<b>3.4</b>	<b>6</b>	<b>7</b>	<b>13</b>
Parent	1.4	1.7	2.1	1.4	1.8	2.2	1.2	2.0	2.0	2.3	2.2	2.3	7	7	9
Shinjin ESCO	-	-	-	-0.1	-0.5	-0.7	-0.9	0.0	0.2	0.2	0.3	0.5	0	-2	1
Cutting machines	-	-	-	-	-	1.7	0.3	0.2	0.7	0.7	0.6	0.6	0	2	3
Overseas subsidiaries	0.0	-0.5	-0.2	0.0	-0.1	-0.3	-0.4	-0.1	0.1	0.1	0.1	0.1	-1	-1	1
Revenue adj.	-0.1	-0.1	0.1	0.1	0.5	-	0.1	-	-	-	-	-	0	1	0
<b>OP margin</b>	<b>12.2%</b>	<b>9.6%</b>	<b>14.0%</b>	<b>12.6%</b>	<b>14.7%</b>	<b>16.7%</b>	<b>2.3%</b>	<b>12.7%</b>	<b>16.1%</b>	<b>17.1%</b>	<b>15.7%</b>	<b>15.8%</b>	<b>12.2%</b>	<b>11.9%</b>	<b>16.2%</b>
<b>Net profit</b>	<b>1.3</b>	<b>0.7</b>	<b>1.7</b>	<b>1.8</b>	<b>1.1</b>	<b>2.0</b>	<b>-0.3</b>	<b>2.6</b>	<b>2.5</b>	<b>2.5</b>	<b>2.7</b>	<b>3.3</b>	<b>5</b>	<b>5</b>	<b>11</b>

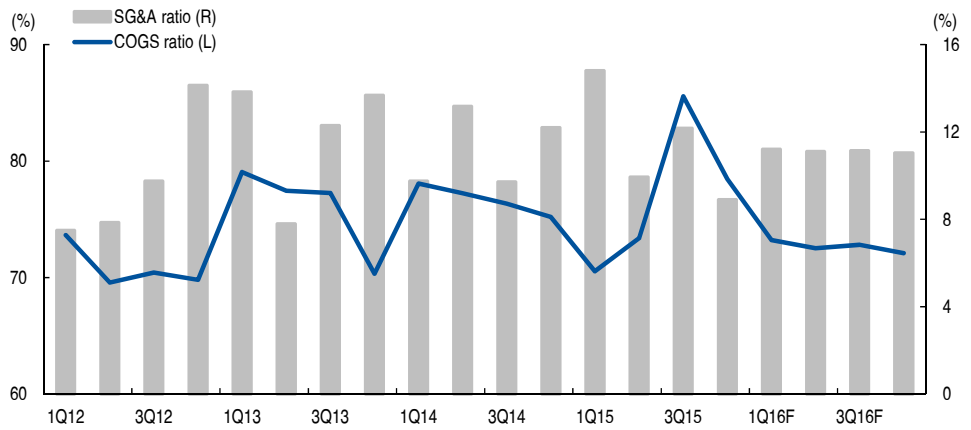
Source: Company data, KDB Daewoo Securities Research

Figure 19. Shinjin SM's actual output and utilization



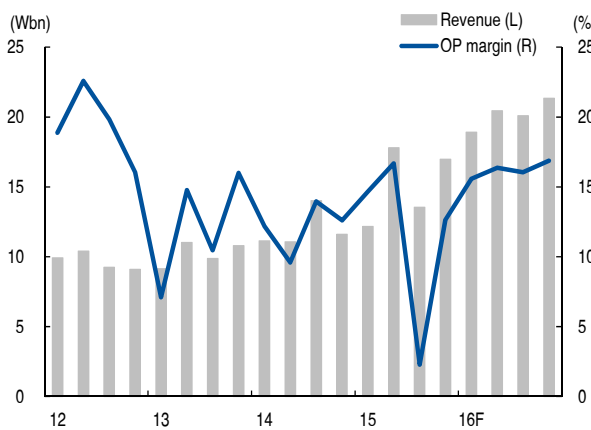
Source: Company data, KDB Daewoo Securities Research

Figure 20. COGS and SG&A ratios



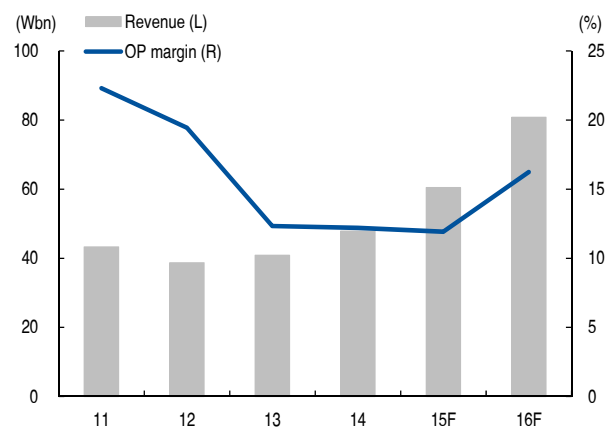
Source: Company data, KDB Daewoo Securities Research

Figure 21. Quarterly earnings



Source: Company data, KDB Daewoo Securities Research

Figure 22. Annual earnings



Source: Company data, KDB Daewoo Securities Research

## VII. Valuation

We initiate our coverage on Shinjin SM with a Buy rating and target price of W25,000. We derived our target price by applying to our 2016F EPS of W1,195 a P/E of 21x, the weighted average multiple of 1) machinery parts suppliers, 2) companies boasting similar market dominance, and 3) players with comparable growth potential <Table 7>.

### 1. Valuation comparison: Machinery parts suppliers

There is no true peer in the machinery sector that is directly comparable to Shinjin SM. In light of this, we based the machinery component of our target multiple on the average 2016F P/E (14.5x) of key market-leading companies suffering from slowing growth due to market slumps (TK Corp. and SungKwang Bend for plant components; YG-1, Hy-Lok, and Kishin for machinery parts).

### 2. Valuation comparison: Companies boasting similar market dominance

Our target multiple also factored in the average multiple of key companies boasting market dominance similar to that of Shinjin SM, as they are generally able to generate stable cash flow and make market share gains even during market slumps. These companies are LS Industrial Systems (LSIS), KCC, Ottogi, and Koh Young Technology, for which the average 2016F P/E stands at 18.4x.

### 3. Valuation comparison: Players with comparable growth potential

We also took into account the valuations of companies with growth potential comparable to Shinjin SM's. These companies are Korea Aerospace Industries (KAI), ASTK, and Orbitech, which boast a lofty average 2016F P/E of 33.1x.

Rapidly growing firms often see their profitability fall on massive capex in the short term, but see margin improvement with the onset of mass production or sales growth. Shinjin SM is not an exception. The company, which experienced falling profitability due to capacity expansion over the past year, is likely to see a recovery on full-swing production at its subsidiaries in 2016. Given its outstanding market dominance, the company will likely deliver high growth in the medium- to long-term.

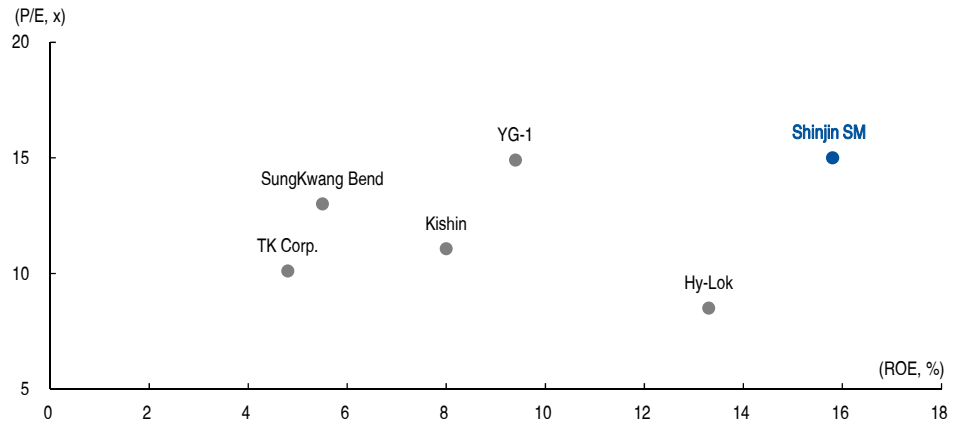
We derived our target P/E of 21x based on the weighted average (4:3:3) multiple of the aforementioned three groups of firms.

Table 7. Valuation

Industry	Company	Sector	2016F			
			P/E	Avg. P/E	Weight	P/E
Machinery	TK Corp.	Fittings/valves	17.4	14.5	0.4	5.8
	SungKwang Bend	Fittings/valves	17.9			
	YG-1	Cutting tools	14.9			
	Hy-Lok	Fittings/valves	12.2			
	Kishin	Mold bases	10.2			
Dominant market position	LSIS	Electronics	10.2	18.4	0.3	5.5
	KCC	Construction materials	17.2			
	Ottogi	F&B	29.9			
	Koh Young	IT solutions	16.2			
Growth/profitability	KAI	Airframes	29.4	33.1	0.3	9.9
	ASTK	Aircraft parts	50.8			
	Orbitech	Aircraft parts	19.0			
<b>Total</b>						<b>21.2</b>

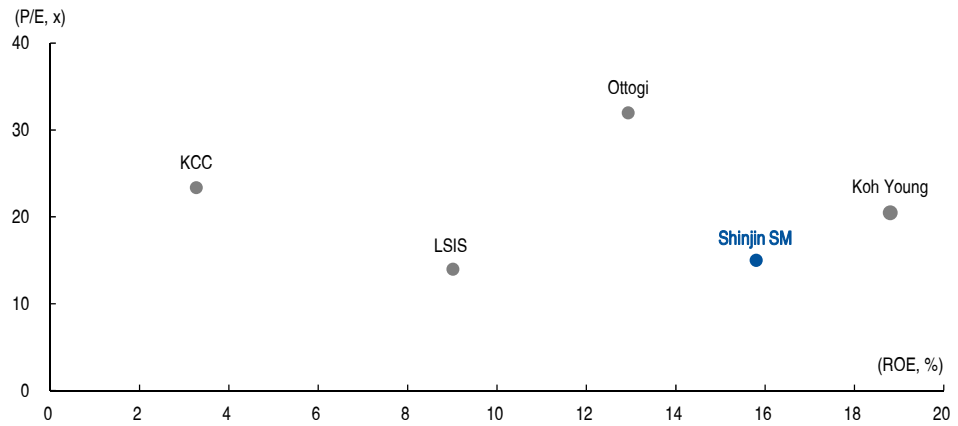
Source: WISEfn, KDB Daewoo Securities Research

Figure 23. P/E-ROE comparison: Machinery parts suppliers (2016F)



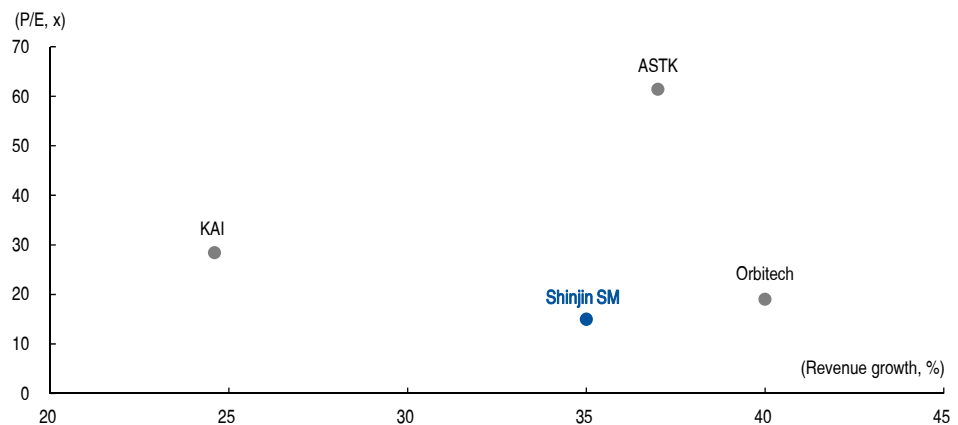
Source: Bloomberg, KDB Daewoo Securities Research

Figure 24. P/E-ROE comparison: Companies with dominant market positions (2016F)



Source: Bloomberg, KDB Daewoo Securities Research

Figure 25. P/E-revenue growth comparison: Firms with high growth potential (2016F)



Source: Bloomberg, KDB Daewoo Securities Research

## VIII. Financial analysis and risks

### 1. Stable financials

Under K-IFRS, Shinjin SM held cash and cash equivalents of W14bn as of 3Q15. Although its cash holdings decreased by around W10bn from the end of last year, most of the contraction was due to investments in the setup of its subsidiaries. The company has stable financials, with a consolidated debt-to-equity ratio of only 48% and an interest coverage ratio of 20x. Furthermore, the company pays only around 2% interest on its debt.

### 2. Sluggish downstream industries

The global economic slowdown, yen depreciation, and China’s protectionist policies have been negatively affecting domestic machinery firms. Furthermore, growth of machinery exports to Europe is likely to slow due to the Volkswagen emissions scandal. Capacity ramps-up at Korean machinery firms are expected to weaken, as they should struggle in competition with their Japanese peers. In addition, the auto, electric/electronic, plant, and steel sectors, which are major sources of demand for plates, are also likely to be sluggish.

### 3. Challenges in the large-sized plate market

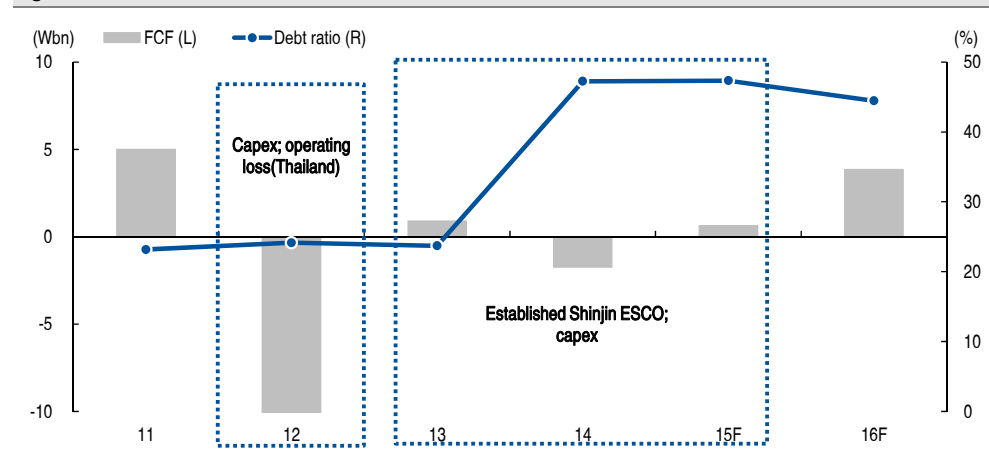
In 2015, the company established Shinjin ESCO to expand into the large-sized plate market. Since the customer base of the large-sized plate market is different from that of the small-sized plate market, it will likely be difficult to achieve customer base expansion in the short term. Therefore, Shinjin SM is applying its existing strategy of adding distribution partners to Shinjin ESCO.

### 4. Heavy plate price cuts and intense competition

Shinjin SM’s sales prices (for long steel and plates) move in line with those of heavy plates (raw material). As such, if heavy plate prices fall, revenue growth is unlikely to be as robust as sales volume expansion. Indeed, the company’s long steel sales volume increased by 25% YoY for the first three quarters of 2015, while its long steel revenue expanded by only 17% YoY due to the heavy plate price cut of more than 15%. (POSCO cut its heavy plate prices sharply to compete with Chinese rivals.) An additional price cut of around 5% is expected to occur in 2016.

Competition with standardized plate makers that use Chinese heavy plates as raw materials is also an issue. Indeed, Shinjin SM uses heavy plates produced by POSCO. Although the company still boasts higher cost competitiveness than its Chinese rivals, its profitability could deteriorate in the event of intense competition.

Figure 26. FCF & debt ratio trends



Source: Company data, Daewoo Securities Research

## Appendix: Major patents

### Circular saw cutting technology using a wedge

One of Shinjin SM’s major patents is related to the insertion of a wedge into a steel sheet being cut by a circular saw, thus preventing the saw from becoming stuck. This technology is aimed at keeping the gap between sections from closing by applying constant pressure, preventing damage to the saw blade, and efficiently discharging scrap.

A circular saw-based cutting tool for small-sized plates can be seen in <Figure 27>. The circular saw cuts into a plate <Figure 28>. When the saw reaches a certain point, the two sides bend and stick together, stopping the saw from progressing further. Then, a wedge is inserted between the sections, creating a gap <Figure 29>. The wedge ensures that the saw keeps moving forward. <Figure 30>.

Figure 27. Cutting machine

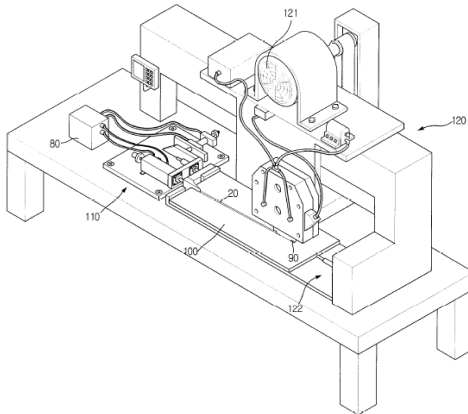
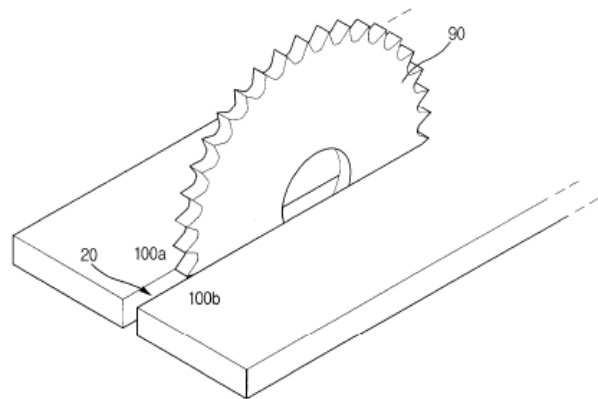


Figure 28. Circular saw blade



Source: Korean Intellectual Property Office, KDB Daewoo Securities Research

Source: Korean Intellectual Property Office, KDB Daewoo Securities Research

Figure 29. Overhead view of cutting machine

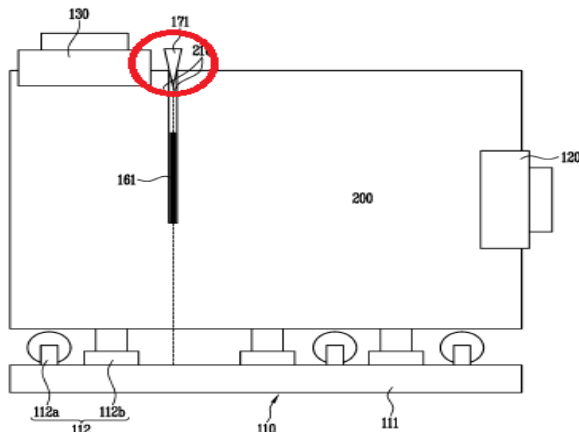
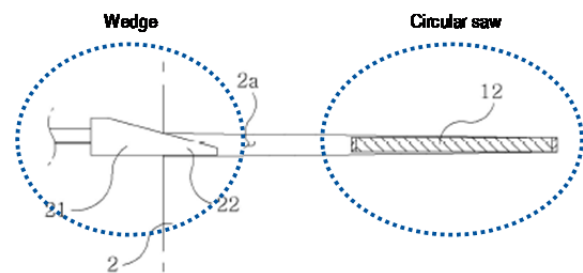


Figure 30. Circular saw blade and wedge



Source: Korean Intellectual Property Office, KDB Daewoo Securities Research

Source: Korean Intellectual Property Office, KDB Daewoo Securities Research

## Shinjin SM (138070 KQ/Buy/TP: W25,000)

## Comprehensive Income Statement (Summarized)

(Wbn)	12/14	12/15F	12/16F	12/17F
<b>Revenue</b>	<b>48</b>	<b>60</b>	<b>81</b>	<b>101</b>
<b>Cost of Sales</b>	<b>37</b>	<b>47</b>	<b>59</b>	<b>71</b>
<b>Gross Profit</b>	<b>11</b>	<b>13</b>	<b>22</b>	<b>30</b>
<b>SG&amp;A Expenses</b>	<b>5</b>	<b>7</b>	<b>9</b>	<b>11</b>
<b>Operating Profit (Adj)</b>	<b>6</b>	<b>7</b>	<b>13</b>	<b>18</b>
<b>Operating Profit</b>	<b>6</b>	<b>7</b>	<b>13</b>	<b>18</b>
<b>Non-Operating Profit</b>	<b>0</b>	<b>-2</b>	<b>0</b>	<b>0</b>
Net Financial Income	0	0	0	0
Net Gain from Inv in Associates	0	0	0	0
Pretax Profit	6	5	13	18
Income Tax	1	1	2	3
Profit from Continuing Operations	5	4	11	15
Profit from Discontinued Operations	0	0	0	0
<b>Net Profit</b>	<b>5</b>	<b>4</b>	<b>11</b>	<b>15</b>
Controlling Interests	5	4	11	16
Non-Controlling Interests	0	0	0	0
<b>Total Comprehensive Profit</b>	<b>5</b>	<b>4</b>	<b>11</b>	<b>15</b>
Controlling Interests	5	4	11	16
Non-Controlling Interests	0	0	0	0
EBITDA	9	10	16	21
FCF (Free Cash Flow)	-2	1	4	11
EBITDA Margin (%)	18.8	16.7	19.8	20.8
Operating Profit Margin (%)	12.5	11.7	16.0	17.8
Net Profit Margin (%)	10.4	6.7	13.6	15.8

## Statement of Financial Condition (Summarized)

(Wbn)	12/14	12/15F	12/16F	12/17F
<b>Current Assets</b>	<b>59</b>	<b>66</b>	<b>79</b>	<b>95</b>
Cash and Cash Equivalents	26	24	26	34
AR & Other Receivables	10	12	17	21
Inventories	22	27	33	36
Other Current Assets	1	3	3	4
<b>Non-Current Assets</b>	<b>36</b>	<b>34</b>	<b>33</b>	<b>33</b>
Investments in Associates	0	0	0	0
Property, Plant and Equipment	33	30	29	27
Intangible Assets	1	0	0	0
<b>Total Assets</b>	<b>95</b>	<b>100</b>	<b>112</b>	<b>128</b>
<b>Current Liabilities</b>	<b>24</b>	<b>25</b>	<b>27</b>	<b>28</b>
AP & Other Payables	4	5	7	9
Short-Term Financial Liabilities	17	17	17	16
Other Current Liabilities	3	3	3	3
<b>Non-Current Liabilities</b>	<b>7</b>	<b>7</b>	<b>8</b>	<b>8</b>
Long-Term Financial Liabilities	6	6	6	6
Other Non-Current Liabilities	1	1	2	2
<b>Total Liabilities</b>	<b>31</b>	<b>32</b>	<b>35</b>	<b>36</b>
<b>Controlling Interests</b>	<b>60</b>	<b>63</b>	<b>73</b>	<b>87</b>
Capital Stock	4	4	4	4
Capital Surplus	14	14	14	14
Retained Earnings	43	47	56	71
<b>Non-Controlling Interests</b>	<b>5</b>	<b>5</b>	<b>5</b>	<b>5</b>
<b>Stockholders' Equity</b>	<b>65</b>	<b>68</b>	<b>78</b>	<b>92</b>

## Cash Flows (Summarized)

(Wbn)	12/14	12/15F	12/16F	12/17F
Cash Flows from Op Activities	6	1	5	12
Net Profit	5	4	11	15
Non-Cash Income and Expense	4	4	5	5
Depreciation	3	3	2	2
Amortization	0	0	0	0
Others	1	1	3	3
Chg in Working Capital	-3	-7	-8	-6
Chg in AR & Other Receivables	-3	-3	-4	-4
Chg in Inventories	-1	-6	-5	-3
Chg in AP & Other Payables	1	1	1	1
<b>Income Tax Paid</b>	<b>-1</b>	<b>-1</b>	<b>-2</b>	<b>-3</b>
Cash Flows from Inv Activities	-7	-1	-2	-2
Chg in PP&E	-7	0	-1	-1
Chg in Intangible Assets	0	0	0	0
Chg in Financial Assets	0	-1	-1	-1
<b>Others</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
Cash Flows from Fin Activities	19	-1	-1	-2
Chg in Financial Liabilities	15	0	0	-1
Chg in Equity	0	0	0	0
Dividends Paid	-1	-1	-1	-1
<b>Others</b>	<b>5</b>	<b>0</b>	<b>0</b>	<b>0</b>
Increase (Decrease) in Cash	17	-2	2	8
Beginning Balance	8	26	24	26
<b>Ending Balance</b>	<b>26</b>	<b>24</b>	<b>26</b>	<b>34</b>

Source: Company data, KDB Daewoo Securities Research estimates

## Forecasts/Valuations (Summarized)

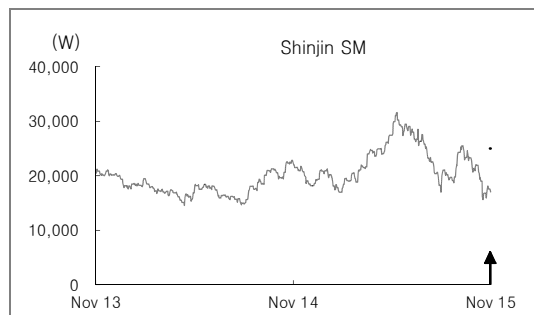
	12/14	12/15F	12/16F	12/17F
P/E (x)	29.8	37.1	14.7	10.2
P/CF (x)	16.6	18.5	10.1	7.6
P/B (x)	2.7	2.5	2.2	1.8
EV/EBITDA (x)	18.7	16.3	10.2	7.3
EPS (W)	611	474	1,195	1,728
CFPS (W)	1,098	953	1,734	2,313
BPS (W)	6,719	7,084	8,169	9,788
DPS (W)	110	110	110	110
Payout ratio (%)	18.0	23.2	9.2	6.4
Dividend Yield (%)	0.6	0.6	0.6	0.6
Revenue Growth (%)	17.1	25.0	35.0	24.7
EBITDA Growth (%)	12.5	11.1	60.0	31.3
Operating Profit Growth (%)	20.0	16.7	85.7	38.5
EPS Growth (%)	19.1	-22.4	152.1	44.6
Accounts Receivable Turnover (x)	5.6	5.5	5.6	5.4
Inventory Turnover (x)	2.5	2.5	2.7	2.9
Accounts Payable Turnover (x)	13.6	14.2	13.7	12.9
ROA (%)	6.7	4.3	10.1	12.9
ROE (%)	9.5	6.9	15.8	19.3
ROIC (%)	9.0	9.3	15.7	20.7
Liability to Equity Ratio (%)	47.2	47.3	44.5	38.9
Current Ratio (%)	250.3	264.8	292.5	341.1
Net Debt to Equity Ratio (%)	-4.3	-2.0	-4.2	-13.1
Interest Coverage Ratio (x)	20.9	19.8	36.4	52.3

## APPENDIX 1

### Important Disclosures & Disclaimers

#### 2-Year Rating and Target Price History

Company (Code)	Date	Rating	Target Price
Shinjin SM (138070)	11/23/2015	Buy	25,000



#### 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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#### **KDB Daewoo Securities International Network**

##### **Daewoo Securities Co. Ltd. (Seoul)**

Head Office  
34-3 Yeouido-dong, Yeongdeungpo-gu  
Seoul 150-716  
Korea  
Tel: 82-2-768-3026

##### **Daewoo Securities (Europe) Ltd.**

41st Floor, Tower 42  
25 Old Broad St.  
London EC2N 1HQ  
United Kingdom  
Tel: 44-20-7982-8000

##### **Beijing Representative Office**

2401A, 24th Floor, East Tower, Twin Towers  
B-12 Jianguomenwai Avenue  
Chaoyang District, Beijing 100022  
China  
Tel: 86-10-6567-9299

##### **Daewoo Investment Advisory (Beijing) Co., Ltd.**

2401B, 24th Floor, East Tower, Twin Towers  
B-12 Jianguomenwai Avenue,  
Chaoyang District, Beijing 100022  
China  
Tel: 86-10-6567-9699

##### **Daewoo Securities (Hong Kong) Ltd.**

Two International Finance Centre  
Suites 2005-2012  
8 Finance Street, Central  
Hong Kong, China  
Tel: 85-2-2845-6332

##### **Daewoo Securities (Singapore) Pte. Ltd.**

Six Battery Road #11-01  
Singapore, 049909  
  
Tel: 65-6671-9845

##### **Shanghai Representative Office**

Room 38T31, 38F SWFC  
100 Century Avenue  
Pudong New Area, Shanghai 200120  
China  
Tel: 86-21-5013-6392

##### **Daewoo Securities (Mongolia) LLC**

#406, Blue Sky Tower, Peace Avenue 17  
1 Khoroo, Sukhbaatar District  
Ulaanbaatar 14240  
Mongolia  
Tel: 976-7011-0807

##### **Daewoo Securities (America) Inc.**

320 Park Avenue  
31st Floor  
New York, NY 10022  
United States  
Tel: 1-212-407-1000

##### **Tokyo Branch**

7th Floor, Yusen Building  
2-3-2 Marunouchi, Chiyoda-ku  
Tokyo 100-0005  
Japan  
Tel: 81-3- 3211-5511

##### **Ho Chi Minh Representative Office**

Suite 2103, Saigon Trade Center  
37 Ton Duc Thang St,  
Dist. 1, Ho Chi Minh City,  
Vietnam  
Tel: 84-8-3910-6000

##### **PT. Daewoo Securities Indonesia**

Equity Tower Building Lt.50  
Sudirman Central Business District Jl.  
Jendral Sudirman Kav. 52-53, Jakarta Selatan  
Indonesia 12190  
Tel: 62-21-515-1140