

Korea – 2nd quarter 2009 earnings

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Second quarter earnings results were better than expected overall around the world, and I would like to highlight here the results of some major Korean corporates.

IT and auto sectors were among the best, surprising the market. Though the market had expected some QoQ improvement from 1Q when unusually low utilisation and free fall in overall demand (except China) were striking, the improvement turned out much better than expected. Samsung Electronics (SEC) even issued 2Q earnings guidance before the result release. Also note that we had a better than expected 1Q. The still weak Korean won helped largely, but competitiveness in technology and design, and continuous efforts to cut costs, significantly contributed to the 2Q earnings surprises.

The companies like SEC, LG Electronics (LGE), and Hyundai Motor Company (HMC) have gained their market shares under the downturn. The weak Korean won and sound balance sheets have enabled the companies to undertake more aggressive marketing compared to their overseas competitors. HMC explicitly said that the gains from the weak Korean won would be spent on marketing. Along with these companies' strong performance, their supply chains such as SEMCO (parts for PC, TV, handset), Samsung SDI (rechargeable batteries, PDP), LG Display (TV panel), LG Chemical (chemical for IT & Auto, rechargeable batteries, polarisers) and Hyundai Mobis (auto module, service parts) were improving substantially.

SEC, LGE and HMC quarterly key figures are listed below (including GDP growth and FX rates).

		1Q08	2Q08	3Q08	4Q08	1Q09	2Q09
Korea GDP growth	QoQ	1.1	0.4	0.2	-5.1	0.1	2.3
	YoY	5.5	4.3	3.1	-3.4	-4.2	-2.5
FX rates							
KRW/USD (End)		990.4	1,046.0	1,207.0	1,259.5	1,383.5	1,273.9
KRW/USD (Avg)		956.9	1,018.0	1,066.1	1,364.3	1,418.3	1,286.1
JPY/USD (End)		99.15	106.27	103.80	90.22	97.34	96.14
JPY/USD (Avg)		105.32	104.54	107.52	96.16	93.77	97.41
	W bn	1Q08	2Q08	3Q08	4Q08	1Q09	2Q09
Samsung Electronics (Parent)	Sales	17,107	18,139	19,256	18,450	18,566	21,020
	OP	2,154	1,894	1,023	-937	148	1,064
	OPM	12.6%	10.4%	5.3%	-5.1%	0.8%	5.1%
	NP	2,188	2,142	1,219	-22	619	2,254
	Growth QoQ		-2%	-43%	TR	TB	264%
	Growth YoY					-72%	5%
LG Electronics (Parent)	Sales	6,927	7,234	6,887	6,591	7,074	8,477
	OP	564	635	338	-310	437	714
	OPM	8.1%	8.8%	4.9%	-4.7%	6.2%	8.4%
	NP	422	707	25	-671	-198	1,146
	Growth QoQ		68%	-96%	TR	n.m.	TB
	Growth YoY					TR	62%
LG Electronics (with overseas subsidiaries)	Sales	11,218	12,735	12,009	13,371	12,853	14,497
	OP	605	856	571	101	456	1,133
	OPM	5.4%	6.7%	4.8%	0.8%	3.5%	7.8%
Hyundai Motor (Parent)	Sales	8,198	9,107	6,055	8,831	6,032	8,080
	OP	529	663	105	581	154	657
	OPM	6.5%	7.3%	1.7%	6.6%	2.6%	8.1%
	NP	393	547	265	244	225	812
	Growth QoQ		39%	-52%	-8%	-8%	261%
	Growth YoY					-43%	48%

Source: Company data, BOK

* TR: turn red, TB: turn black

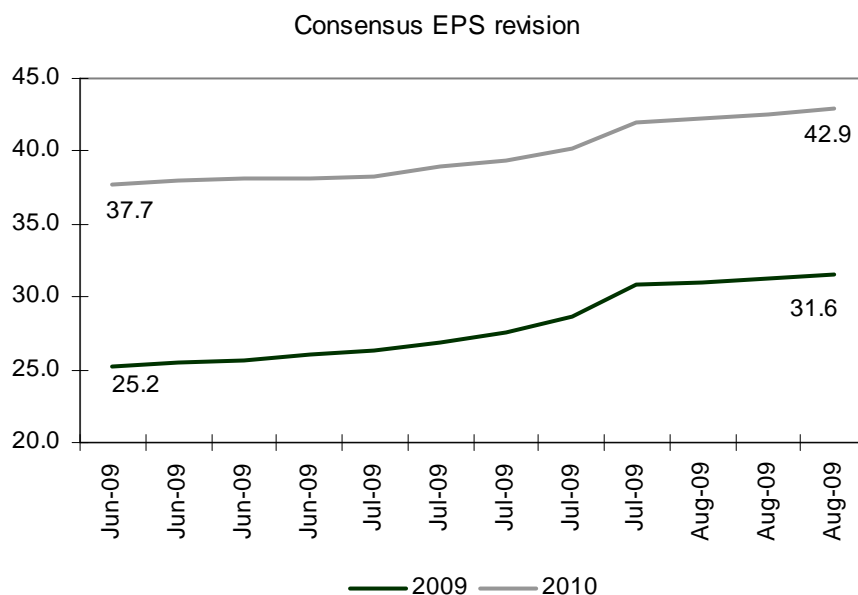
Overall, the main reasons are:

- 👑 China demand is still significant, although developed markets remain weak.
- 👑 The Korean won strengthened QoQ, but was still at quite a depreciated level compared to the rate a year earlier. At the operating level, the positive impact from FX might have been reduced for exporters with the currency appreciation, but those with USD denominated debt had benefits at the pre tax profit level through FX translation gains (non cash though) - see FX rate at the table above.
- 👑 Market share gains continue through aggressive marketing with still positive FX and through fundamentally better technology and design.
- 👑 Cost reduction.

Looking at their main improvements more specifically:

- 👑 IT - SEC and LGE gaining market share in handsets and Flat panel TVs.
 - Handset sales growth was significant QoQ and even YoY. SEC grew 14% both QoQ and YoY to 52.3mn unit and LGE grew 32% QoQ and 8% YoY to 29.8mn unit sales. According to CLSA (quoting Strategy Analytics), the market shipment in 2Q grew 12% QoQ but declined 8% YoY to 273mn units. As a result, SEC global market share reached 19.2% from 18.7% in 1Q and LGE recorded 10.9%, the first double digit market share at the expense of three other major players, Nokia, Motorola and Sony Ericsson.
 - Flat Panel TV sales - SEC shipments grew more than 10% QoQ and LGE grew 21% QoQ. According to SEC, the market grew 6% QoQ. More on LCD TV (67% of total TV market sales as of 2Q09), according to CLSA (quoting DisplaySearch), LGE shipped 3.55mn units in 2Q (+11% QoQ, +51% YoY), taking the LCD TV market share of 11.8% (No.2), the first time beating Sony. SEC market share of 18.8% (5.65mn sold), maintaining No.1 position. Total LCD TV market shipment in 2Q was 30mn (+12% QoQ, +27% YoY). China LCD TV market growth was significant partly with the government subsidies on home appliances in the rural areas and also structurally with low penetration. 2Q LCD TV market in China grew 13% QoQ and 111% YoY to 5.6mn units. Top 5 local players (Skyworth, Hisense, TCL, Konka and Changhong) take 73.9% market share and LGE is the only foreign brand with meaningful share (4.7%).
 - Korean players' initiatives continue including LED TV (LED BLU LCD TV), AMOLED handsets.
- 👑 Auto - HMC gaining the market share in the two largest markets - US and China
 - Overall, government stimulus plans in various markets (scrappage incentives, tax incentives, etc.). Still Japanese Yen strength against USD. Good volume sales in the two largest markets, China and US, outperforming the market growth. Regional balance. More focus on small cars.
 - Domestic market - Excise tax incentives ended in June so there was some exceptional demand in 2Q, especially in June. Also, scrappage program to end in Dec 2009. HMC 2Q domestic sales volume was up 16% YoY (55% up in June in particular), up 44% QoQ.
 - China – As of 1H09, HMC market share in China recorded 7.2%, no. 4 position. 2Q sales volume grew 66% YoY and 18% QoQ.
 - US – As of 1H09, HMC market share came at 4.3%, June at 4.4%. 2Q sales volume down 20% YoY while up 14% QoQ.
 - HMC global market retail sales volume in 2Q remained flat YoY but up 23% QoQ to 820K units.
 - US market share in July improving to 4.6%, volume up 11%. We also hear strong China sales - July volume growth is c.97% YoY.

Post 2Q earnings releases, consensus earnings have been revised up substantially. SEC net profit usually accounts for c.16% of MSCI Korea earnings, thus earnings revision from the company make a significant impact. Also with other company earnings revisions, latest MSCI consensus EPS growth is estimated to be 36.0% for 2009 and 35.7% for 2010 according to Morgan Stanley (see below the trend of EPS revision). EPS growth forecasts were 8.5% in 2009 and 49.7% in 2010 at the beginning of June after 1Q release. MSCI Korea is trading at a P/E of 14.1x for 2009 and 10.4x for 2010, P/B of 1.4x 2009 and 1.3x 2010 with ROE of 10.2% in 2009 and 12.4% in 2010. FYI, MSCI AC Asia ex Japan is trading at a P/E of 17.3x 2009 and 13.5x 2010 (EPS growth of 8.7% in 2009 and 27.7% in 2010), PB of 1.8x 2009 and 1.7x 2010 with ROE of 10.6% and 12.4% for 2009 and 2010 respectively.



Source: MSCI, data from Morgan Stanley reports (weekly revision)

*Earnings season started in mid July. SEC issued 2Q guidance on 6 July from which the major revision on SEC started. Actual result announcement for SEC was made on 24 July.

We hear good 3Q numbers. Concerns remain on how to cope with the appreciating Korean won, how fast real demand can pick up so that it can offset the possible slowdown in China demand. Market share gains through downturns should help at the upturn, widening the gaps with competitors.

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