Hyosung TNC
Shareholder policy disappeared after split

Value Investment Div.
KB Asset Manangement

2018.12.14

국민의 평생 자산운용 파트너
KB자산운용

국민의 평생 금융파트너

KB금융그룹

Shareholder policy disappeared after split (Summary)

- KB Asset Management Value Investment Division has invested in Hyosung TNC since 2016, based on its business structure and excellent cash generation ability to maintain high margin, and is now a friendly investor with a 14.7% stake. We are always grateful for the efforts of the board of directors and management who have maintained the top position in a rapidly changing market environment with a passion for technology.
- However, five months after the spin-off, four subsidiaries, excluding Hyosung Corporation, have not announced their shareholder policies. And the market cap of Hyosung Group as a whole fell by 38%
- We introduced the stewardship code from December 2017 and now we are asking the followings to fulfill our faithfulness as trustee of our customer assets

1. We know that dividends will decrease in 2018, which consists of only seven months after the split, so profit available for dividend is not enough. However, shareholder policy is not an option but a necessity in current Korean capital market . Please announce long term shareholder policy (such as dividend, buyback/cancellation of treasury shares, par value division, differential dividend).
2. We understand that debts are burdensome. However, if FCF is used solely for repayment of debts, shareholders will not be paid dividend for the next 11 years. Considering its CAPEX cycle and excessive share price decline, we think it is appropriate to use 30% of FCF for shareholder return.

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Hyosung TNC is a domestic textile company with 52 years of experience manufacturing spandex. KB Asset Management has been investing for two years and seven months since May 2016

국민의 평생 자산운용 파트너 KB자산운용

History

1957: Founder of the group, Cho Hong-jae, founded Hyosung Mulsan

1966: Established Dongyang Nairon (currently Hyosung TNC) producing nylon yarn

1975: Acquired HanYoung Industrial Co., Ltd. (now Hyosung Heavy Industries) and entered the heavy industry business

1984: President Cho Hong-jae inherited Hyosung Products, Dongyang Polyester, and Hyosung Heavy Industries Co.

1990: Developed proprietary spandex technology

1998: Hyosung T & C, Hyosung Life Industry, Hyosung Products, and Hyosung Heavy Industries were merged into Hyosung as one company after experiencing IMF

2007: Cho, Seok-rae's eldest son Cho Hyun Jun was appointed president of the textile / trade division

2016: Cho Hyun Jun inaugurated as president of Group

2018: Hyosung Group divided into Hyosung TNC, Hyosung Advanced Materials, Hyosung Heavy Industries, Hyosung Chemical, and Hyosung Corporation

Ownership

KBAM 14.70%

Cho, Hyun Jun (The eldest son) 14.59%

Cho, Hyun sang (The third son) 12.21%

Cho, Seok-rae (Ex-president) 10.18%

Hyosung 5.26%

Business

1) Textile (48% of sales)

: Spandex, Polyester yarn, nylon yarn

2) Trade (52% of sales)

: General trading, real estate rental, tire cord, NF3

* Source: Electronic Disclosure System, Naver Institutional Group Dictionary, Doosan Encyclopedia, KB Star F, Dec. 1, 2018

Hyosung is expected to hold a 21% stake in Hyosung T & C after the swap between subsidiaries and new owners of the holding company (expected to be completed on December 20, 2018)

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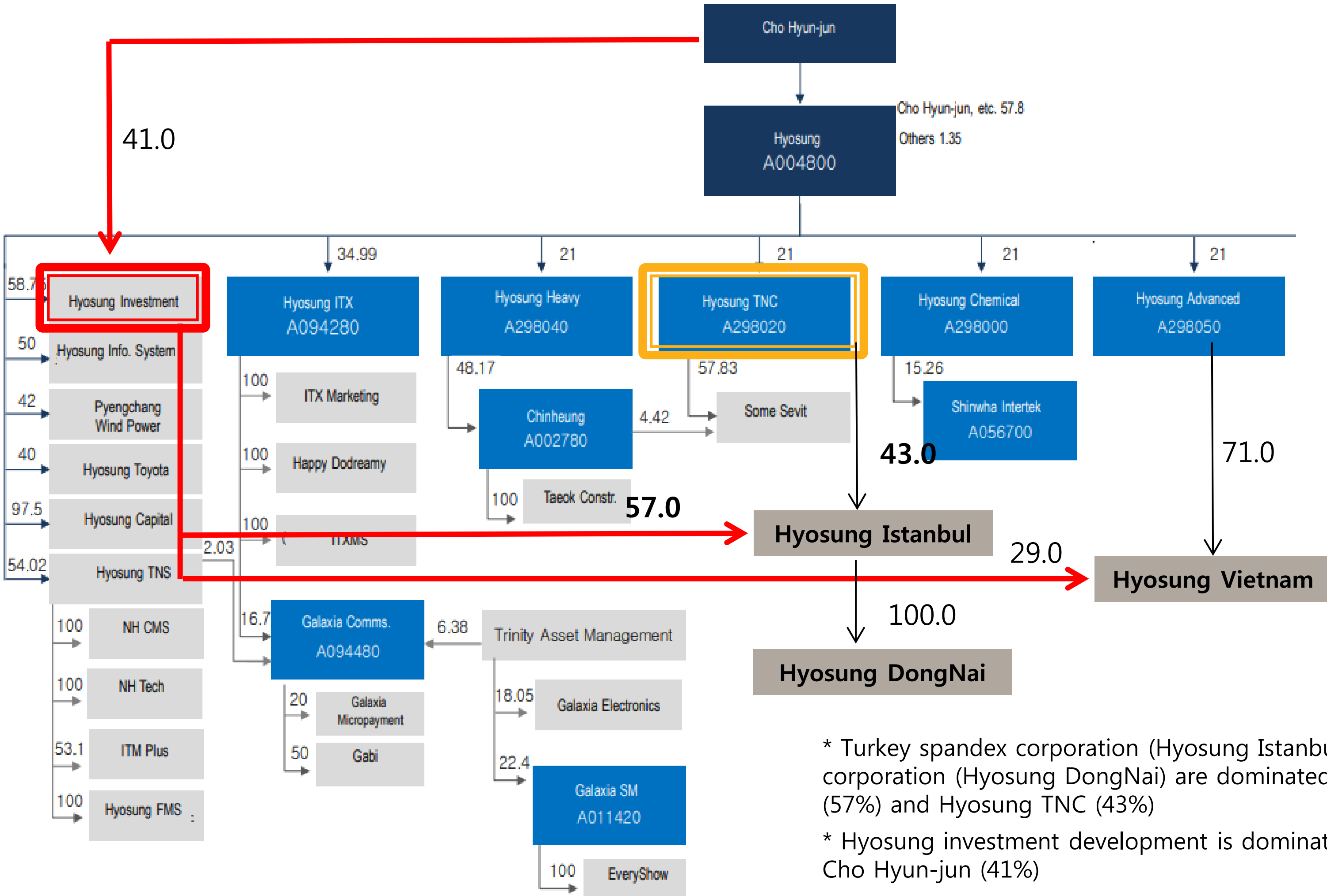
The corporate governance structure of Hyosung Group (expected)



* Turkey spandex corporation (Hyosung Istanbul) and Vietnam spandex corporation (Hyosung DongNai) are dominated by Hyosung Investment (57%) and Hyosung TNC (43%)

* Hyosung investment development is dominated by Hyosung (59%) and Cho Hyun-jun (41%)

* Source: 'Hyosung - Dividend yield attractive', Ji-Yang Yang, 2018.11.26, Daishin Securities

Although Hyosung TNC is a latecomer, it has become the No. 1 global player (M/S 32%) in seven years due to its high level of technical expertise

Spandex Features

1) The first spandex

: In 1958 DuPont developed spandex, a fabric that stretches well. Elastane in Europe, and Lycra in other markets

2) Features

: It features elasticity that increases by 4-8 times.

: In the past, it has been used in sports apparel such as swimwear and yoga suits, but now it is mixed with most apparel (1 ~ 5%)

3) Market

: CAGR of 9.6% for five years from 560,000 tons in 2014 to 800,000 tons in 2018

: Expansion of functional sports apparel market, increase of mixed spandex in living apparel, growth of diaper market

Hyosung's spandex Creora

1) Rebellion of latecomer

: Started its own research and development as latecomer in 1990

: Launched the Creora brand in the market in 1995

: Hyosung defeated Invista (DuPont's acquisition of Lycra), the industry's No. 1 in seven years

2) Differentiated product market

: Only Hyosung and Invista can produce high-priced differentiated products in spandex market with various grades

: Hyosung's differentiated product portion 60%

* Source: Electronic Disclosure System, Company Data, Wikipedia

Hyosung TNC's textile division has a high operating margin (13% on average for nine years) based on its differentiated spandex products.

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Hyosung TNC's textile division earnings estimates

(000' Tons, Wbn)	FY07	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16	FY17	FY18E	FY19E	FY20E
WTI (USD)	96	45	79	91	99	92	98	53	37	54	60	60	55	50
Global spadex demand								556	588	630	742	800	845	899
Hyosung sales								161	180	203	220	258	292	313
M/S								29%	31%	32%	30%	32%	35%	35%
Growth rate (%)									12%	13%	8%	17%	13%	7%
Textile sales	870	931	903	1,760	1,906	2,004	2,180	2,168	2,105	1,979	2,137	2,506	2,836	3,040
Textile OP	**48**	**45**	**87**	**281**	**106**	**128**	**268**	**366**	**425**	**313**	**249**	**200**	**312**	**395**
opm (RHS)	6%	5%	10%	16%	6%	6%	12%	17%	20%	16%	12%	8%	11%	13%

Key assumptions

-FY07 ~ FY17 are sales and operating profit of textile division announced by Hyosung

-FY18E ~ FY20E are estimates of Hyosung T & C's textile division after spin-off

- Estimate sales based on the expansion plan provided by the company. ASP fixed
- The OP margin is expected to return to the past 9 year average considering oil price and competitor expansion.
- Assuming that Hyosung advanced material and subsidiary swaps

(Eliminating TNC's tire cord profit and adding spandex profits from advanced materials)

*Source: Electronic Disclosure System, Bloomberg, Quantiwise, IR, KB Asset Management assumption

Although profitability deteriorated due to capacity expansion and rising oil prices in China during FY17 ~ FY18, it is expected to gradually return to the previous average level

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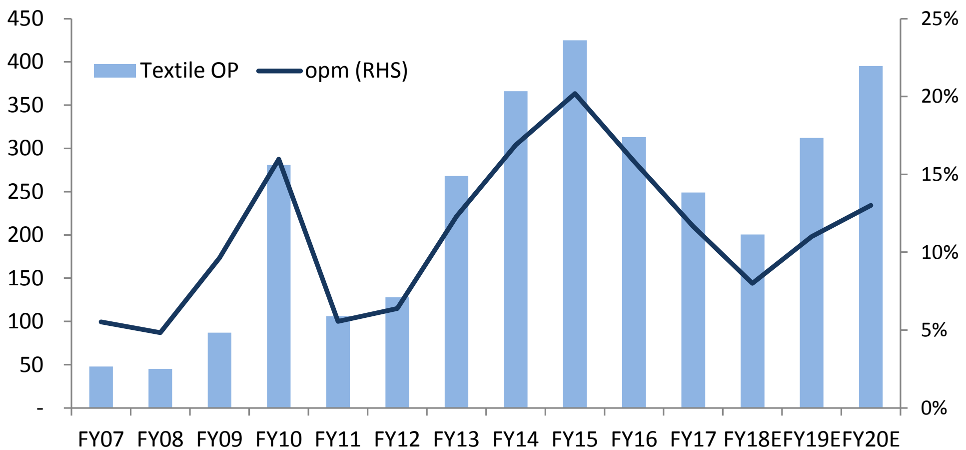
Textile OP vs OPM

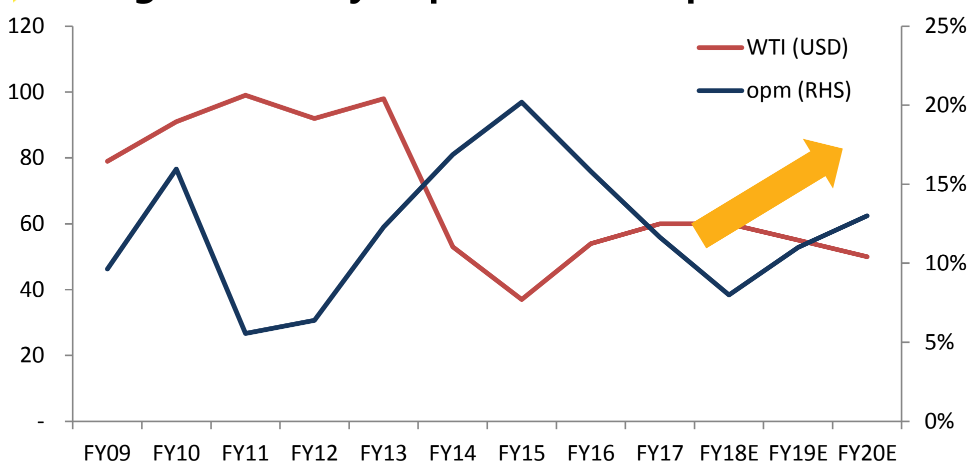


<u>-FY13-FY16 high profits thanks to preemptive capacitity expansion in FY10</u>

-FY17-FY18 has suffered profits due to overcapacity in China and rising oil prices

- In 2Q18 and 3Q18, it recorded low margin as Chinese subsidiary turned to red

Margin recovery expected as oil prices declines



- OP margin is affected by: 1) price changes due to supply/demand, 2) cost changes due to oil price

- Cost (BDO, MDI) is much more volatile than ASP. As a result, margin is improving in low oil price environment

* Source: Electronic Disclosure System, Bloomberg, Quantiwise, IR, KB Asset Management assumption

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After the spin-off, Hyosung Group's combined market cap dropped 38% from W4.7tr to W2.9tr

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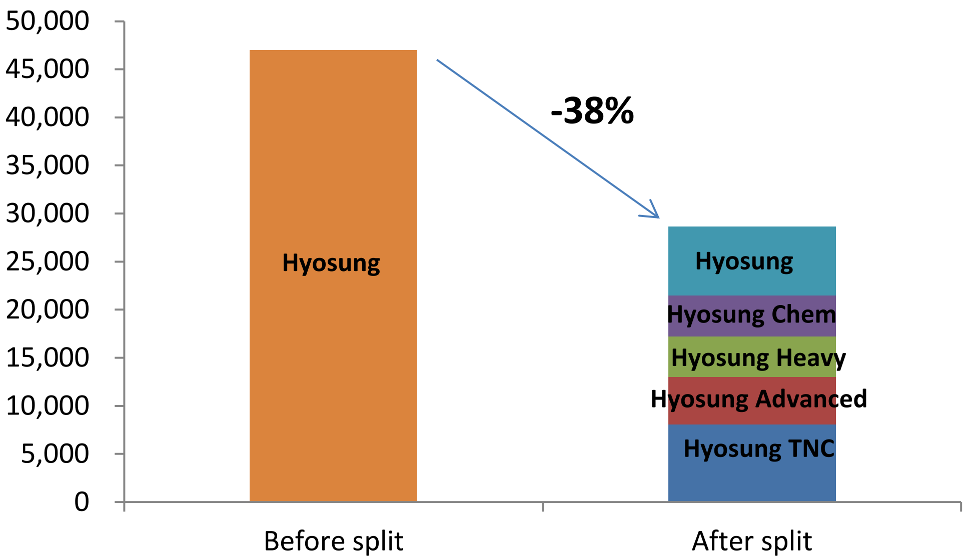
Decreased by 38% after split



* Source: Quantiwise, Based on November 30, 2018

Why?

1) Concerns over governance and shareholder policies

- Absence of shareholder policy

-> Unresolved

2) Margin squeeze due to rising costs

Failure to shift cost to selling price due to sluggish downstream demand

-> As the oil price drops to $50, the margin issue has been resolved.

3) Market decline due to deepening of US-China trade disputes

- After the re-listing, Hyosung TNC -16% (KOSPI index -9%, KRX chemical index -7%)

-> 7% worse than KOSPI

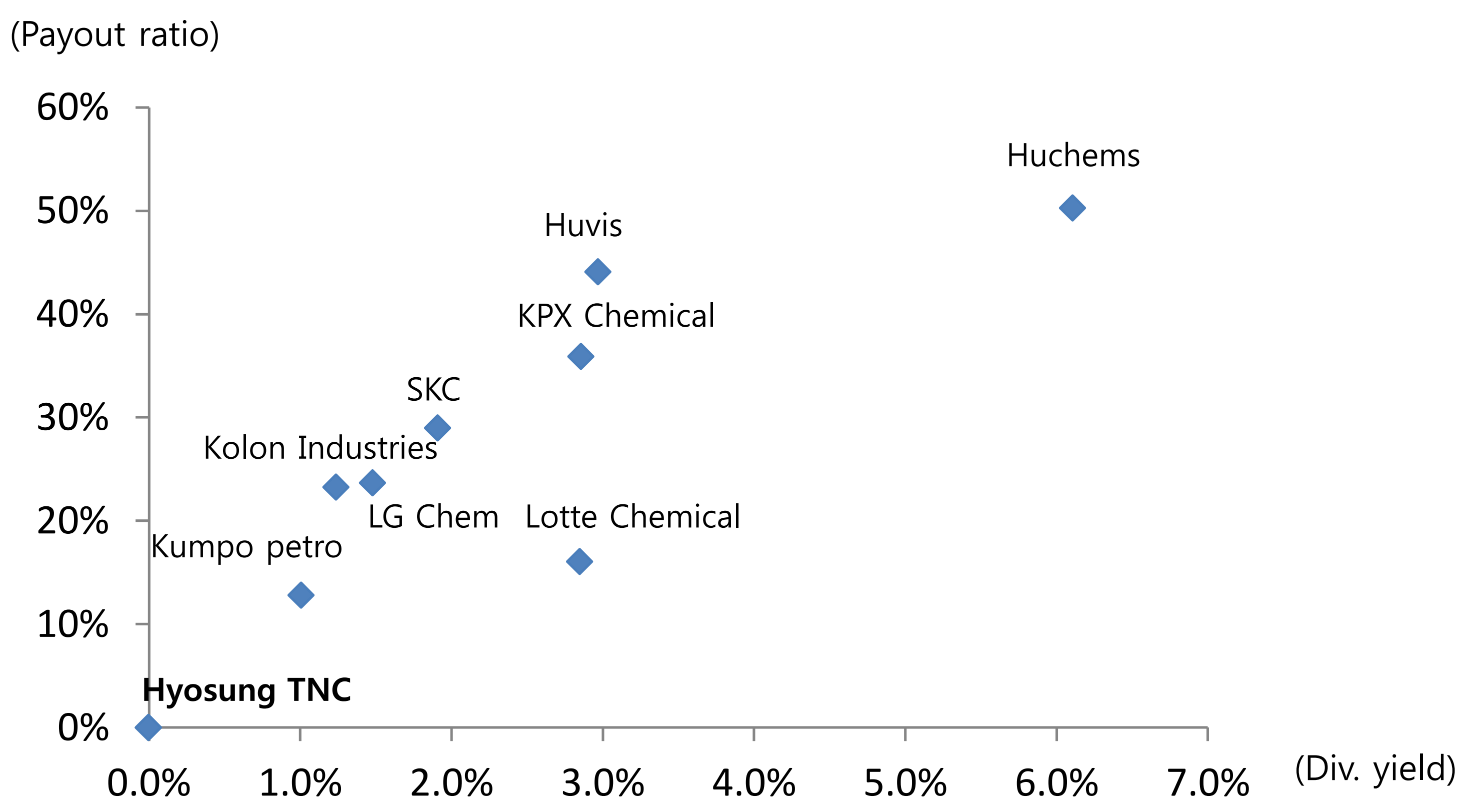
4) Short-term trading issue

As the market cap decreases after the split, it dropped out of various indexes

-> Since it has been around 4 months after spin-off, short-term trading issues have been resolved.

Meanwhile, four subsidiaries including Hyosung TNC have not announced their shareholder policies for more than four months after the split (average dividend payout ratio of domestic major chemical companies is 23%).

Domestic major chemical companies' dividend payout ratio and dividend yield (FY17)



*Source: Quantiwise

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Hyosung TNC generates annual cash flows of W140bn. How should we use this reasonably?

Free cash flow to the equity (FCFE) estimate

1. Basic assumpsion

OP: 9 years' average OP of 284bn (W260bn for textile and 24bn for trade)

D&A: 3Q18 58bn converted to one year, 174 bn

Net interest expense: 3Q18 24.6bn converted to one year, 73.7 bn

2. OCF

Annual OCF = 2840 (1-0.22) + 174 bn = 396 bn

3. CAPEX

Annual CAPEX of 200 bn

3. FCFE

Cash Flow to Shareholders FCFE

= 3960 - 737 (1-0.22) - 2000 = 140 bn

Debt repayment?

Shareholder return?

* Used average 9 year average operating profit to offset cyclical earnings fluctuations

* The average OP for the 9 years came from 2010 (sales of 1.7tn) to 2018 (sales of 2.5tn). Considering FY19E OP of W310bn and FY20E OP of W400bn for the next two years, average OP of 284bn is quite conservative.

* Since the long-term growth rate of spandex has been reduced from 10% to 6%, CAPEX of 200bn is aggressive.

* 3Q18 earnings are reported as 4-month performance from June to September due to split

* Source: Electronic Disclosure System, IR Company

1. Shareholder return began, after all of the borrowing have been repaid

(Wbn)	FY18	FY19	FY20	FY21	FY22	FY23	FY24	FY25	FY26	FY27	FY28	FY29	FY30	FY31	FY32	FY33	FY34	FY35
Net debt	1,800	1,660	1,516	1,367	1,213	1,055	892	723	550	371	186	-4	-4	-4	-4	-4	-4	-4
Interest expense	72	66	61	55	49	42	36	29	22	15	7	0	0	0	0	0	0	0
FCFE	140	144	149	154	158	163	168	174	179	185	190	196	196	196	196	196	196	196
Debt repayment	140	144	149	154	158	163	168	174	179	185	190	0	0	0	0	0	0	0
Shareholder return	0	0	0	0	0	0	0	0	0	0	0	196	196	196	196	196	196	196
PV of Shareholder return	0	0	0	0	0	0	0	0	0	0	0	142	138	134	130	126	122	119
SUM (~FY30)	279																	

2. 70% repay debt and 30% return to shareholder

(Wbn)	FY18	FY19	FY20	FY21	FY22	FY23	FY24	FY25	FY26	FY27	FY28	FY29	FY30	FY31	FY32	FY33	FY34	FY35
Net debt	1,800	1,660	1,517	1,371	1,221	1,069	913	753	591	424	254	80	-97	-279	-464	-654	-847	-847
Interest expense	72	66	61	55	49	43	37	30	24	17	10	3	-4	-11	-19	-26	-34	-34
FCFE	200	204	209	213	218	223	228	233	238	243	248	254	259	265	271	277	283	283
Debt repayment	140	143	146	149	153	156	159	163	166	170	174	178	181	185	189	194	0	0
Shareholder return	60	61	63	64	65	67	68	70	71	73	74	76	78	79	81	83	283	283
PV of Shareholder return	60	60	59	59	58	58	57	57	56	56	55	55	55	54	54	53	176	171
SUM (~FY30)	744																	

*Source: Electronic Disclosure System, KB Asset Estimates

Scenario analysis on the utilization of FCF of W140bn (2)

3. 60% repay debt and 40% return to shareholder

(Wbn)	FY18	FY19	FY20	FY21	FY22	FY23	FY24	FY25	FY26	FY27	FY28	FY29	FY30	FY31	FY32	FY33	FY34	FY35	FY36	FY37
Net debt	1,800	1,716	1,630	1,543	1,454	1,364	1,272	1,178	1,082	985	886	784	681	577	470	361	250	137	22	-96
Interest expense	72	69	65	62	58	55	51	47	43	39	35	31	27	23	19	14	10	5	1	-4
FCFE	140	143	145	148	151	154	156	159	162	165	169	172	175	178	182	185	188	192	195	199
Debt repayment	84	86	87	89	90	92	94	96	97	99	101	103	105	107	109	111	113	115	117	119
Shareholder return	56	57	58	59	60	61	63	64	65	66	67	69	70	71	73	74	75	77	78	80
PV of Shareholder return	56	55	55	54	54	53	52	52	51	51	50	50	49	49	48	47	47	46	46	45
SUM (~FY30)	682																			

4. 50% repay debt and 50% return to shareholder

(Wbn)	FY18	FY19	FY20	FY21	FY22	FY23	FY24	FY25	FY26	FY27	FY28	FY29	FY30	FY31	FY32	FY33	FY34	FY35	FY36	FY37	FY38	FY39	FY40
Net debt	1,800	1,730	1,659	1,587	1,513	1,439	1,363	1,286	1,208	1,129	1,049	967	884	800	714	627	539	449	358	266	172	76	-21
Interest expense	72	69	66	63	61	58	55	51	48	45	42	39	35	32	29	25	22	18	14	11	7	3	-1
FCFE	140	142	144	147	149	151	154	156	158	161	163	166	169	171	174	177	179	182	185	188	191	194	197
Debt repayment	70	71	72	73	74	76	77	78	79	80	82	83	84	86	87	88	90	91	92	94	95	97	98
Shareholder return	70	71	72	73	74	76	77	78	79	80	82	83	84	86	87	88	90	91	92	94	95	97	98
PV of Shareholder return	70	69	68	67	66	65	64	63	63	62	61	60	59	58	57	57	56	55	54	54	53	52	51
SUM (~FY30)	837																						

*Source: Electronic Disclosure System, KB Asset Estimates

If the share price falls sharply compared to intrinsic value as it is now, the effect will be maximized even if only 30% is used for shareholder return (dividend yield of 5.3%).

Summary of scenario analysis

Case	Shareholder return/FCFE	PV of Shareholder return until FY30	Period for debt repayment (년)	Div. Yield
1	0%	279bn	11	0.0%
2	30%	521bn	16	7.5%
3	40%	682bn	19	7.0%
4	50%	837bn	22	8.8%

Implication

1. If the dividend payout ratio is 0%, there will be no cash flow to shareholders until 2029 (for the next 11 years)

2. Given the current market cap of 800 billion won, 30% of ratio generates dividend yield of 5.3%

3. In the period when the share price is greatly discounted compared to the intrinsic value, the effect of share buyback maximizes (shareholder return effect + additional capital gain)

**Source: Electronic Disclosure System, KB Asset Estimates

We believe that a 30% shareholder return on a declining CAPEX cycle will be economically feasible and will greatly help maximize shareholder value.

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At least 30% of FCF should be used for shareholder return

1. In the downward cycle of CAPEX, there is more room for shareholder return

- CAPEX is assumed to be 200 billion won as in the past, but the long-term spandex growth rate has been lowered from 10% to 6%, so CAPEX needs to be lowered -> FCF increase **

2. Capital gain alpha creation

- Higher dividend payout likely to raise its valuation

3. 'Dividend vs share repurchase' depends on shareholders' appetite

- Shareholders and institutional investors (dividend-type funds) who need cash should prefer dividends. However, due to the dividend tax, shareholders who do not have cash interest prefer repurchase / cancelling.

- In the period where share price plunged against corporate value, additional profit can be generated by repurchase / cancelling

** If CAPEX is revised down to W140bn, dividend yield will be reduced from 5.3% to 7.5%, debt repayment period will be reduced from 16 years to 10 years (assuming a 30% return to shareholders)

* Source: Electronic Disclosure System, KB Asset Estimation

Since December 2017, KB Asset Management has introduced the Stewardship code to fulfill our faithfulness obligations.

국민의 평생 자산운용 파트너 KB자산운용

KB Asset Management introduced the Stewardship code (http://www.kbam.co.kr)

KB Star Funds 본문 바로가기 | 오늘 본 상품 (0) | 사이트맵

국민의 평생 자산운용 파트너 KB자산운용

펀드정보 펀드뉴스 회사정보 공지/공시

스튜어드십코드

Home > 스튜어드십코드 수탁자 책임 정책

스튜어드십코드 수탁자 책임 정책 | 의결권 행사 세부지침 | 의결권 행사 내역 보고 | 수탁자 책임 이행 활동 보고

스튜어드십코드 수탁자 책임 정책

1. 기관투자자는 고객, 수익자 등 타인 자산을 관리/운영하는 수탁자로서 책임을 충실히 이행하기 위한 명확한 정책을 마련해 공개해야 한다.

KB자산운용주식회사(이하 '당사')는 1988년 4월 28일 설립되어 유가증권투자에 관한 자문과 정보제공 등의 투자자문업을 영위하여 왔으며, 1997년 7월 증권투자신탁업법 제9조의 규정에 의한 투자신탁운용업 허가에 따라 상호를 주은투자자문주식회사에서 주은투자신탁운용주식회사로 변경하고 증권투자신탁업법에 의한 증권투자신탁업무를 개시하였습니다. 2002년 6월 상호를 국민투자신탁운용주식회사로, 2004년 4월에는 현재의 회사명인 KB자산운용주식회사로 변경하였습니다.

당사는 2009년 2월 자본시장과 금융투자업에 관한 법률(이하 '자본시장법') 제15조의 규정에 의해 투자매매(집합투자증권), 투자중개업(집합투자증권), 집합투자업(모든 종류의 집합투자기구)에 대한 재인가를 받았고, 동 일자로 동 법률 제20조의 규정에 의해 투자자문업과 투자일임업을 등록하였고, 2015년 10월 전문사모집합투자업을 등록하여 금융투자업을 영위하고 있습니다.

당사는 자본시장과 투자대상회사에 대한 깊은 분석 및 이해에 기반한 투자를 지향함에 있어 기관투자자의 수탁자 책임에 관한 원칙(이하 '스튜어드십 코드')을 제정하고 준수하여 수탁자 책임을 이행합니다. 당사의 수탁자 책임은 충실의무와 선관주의의무에 국한하지 않으며 집합투자기구 유형별, 자산군별, 투자 기간 등에 무관하게 일괄적용합니다(단, 인덱스펀드, 상장지수펀드 등의 패시브 펀드의 경우 주주관여활동을 제외합니다).

- 1) We know that dividends will decrease in 2018, which consists of only seven months after the split, so profit available for dividend is not enough. However, shareholder policy is not an option but a necessity in current Korean capital market . Please announce long term shareholder policy (such as dividend, buyback/cancellation of treasury shares, par value division, differential dividend).

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* This letter is a formal fiduciary responsibility implementation activity for compliance with the stewardship code of KB Asset Management and is disclosed in the 'White papers' on the lower left of our website (http://www.kbam.co.kr/kbfr/fund/white_papers.jsp). Please reply to the email address on the right side until January 5, 2019. Thank you. (junbeom.park@kbam.co.kr)

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KB Asset Management Value Management Division has been maintaining its management philosophy of investing in undervalued companies over the past eight years

국민의 평생 자산운용 파트너 KB자산운용

Investment philosophy

Investing in undervalued companies	• Investing in undervalued stocks compared to intrinsic values such as asset value or profit value • Investing in stocks that are expected to have stable earnings growth while being less affected by external changes such as economic fluctuations.
Bottom-up approach	• Selecting stocks based on fundamentals excluding market forecast and economic outlook • Investments focused on stocks with strong intrinsic value, actively investing in the event of a sharp decline due to factors other than fundamentals.
Risk management	• High ethical awareness and integrity-based investment through strict adherence to compliance

"Investment in value stock based on fundamentals"

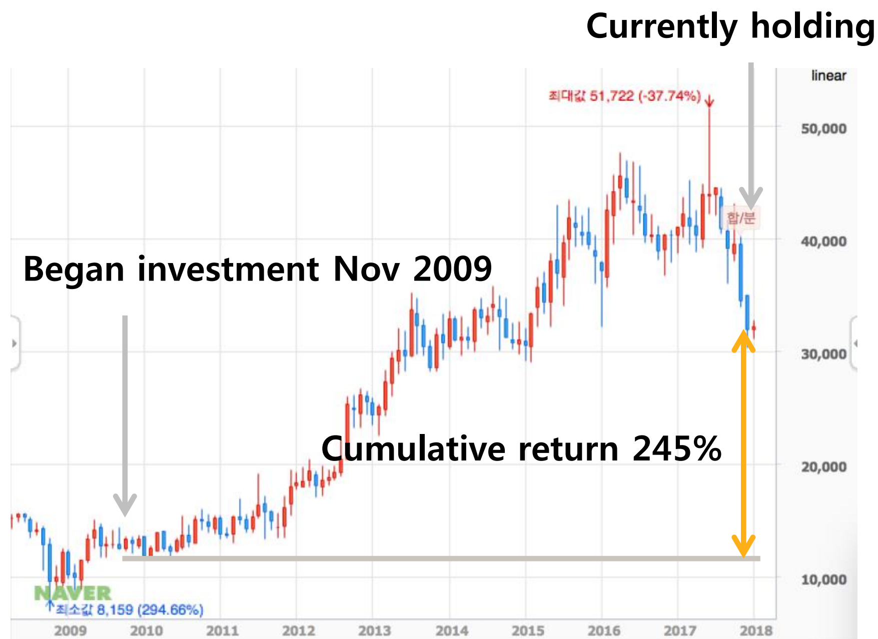
"Maximize long-term compounded income"

We have also been able to maximize compound returns through long-term investments.

국민의 평생 자산운용 파트너
KB자산운용

Investment case (1)
: Semiconductor material manufacturer A

Investment case (2)
: Auto parts supplier B



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THANK YOU

국민의 평생 자산운용 파트너
KB자산운용

국민의 평생
금융파트너

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