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Samsung Electronics' P/E Ratio Gets a Lift From Korean Investors

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January 23, 2006

Samsung Electronics is likely to outstrip International Business Machines this year as the world's largest technology company by revenue. And, at long last, the South Korean company's stock is starting to climb to a level befitting that status.

For years, Samsung shares have been valued well below those of global technology peers on a price/earnings basis. Despite a 46% jump in its share price in 2005, Samsung's P/E ratio is about 11, based on forecast 2006 earnings -- about half of other leading companies in the businesses in which it operates, like Intel Corp. in chips and Nokia Corp. in cellphones.

Samsung's valuation has long suffered, thanks to poor financial disclosure, seesaw profitability and a complex ownership structure that benefited the founding family more than minority shareholders.

Like many companies based in South Korea, Samsung was penalized by what is known as the Korea discount. That discrepancy in valuation is often attributed largely to the anxiety overseas investors feel over the danger posed by North Korea, but also to other factors such as the reluctance of Koreans to invest in their own market.

During the past five years, Samsung has taken steps to raise its historical average P/E ratio. It cut loose many unprofitable products, invested in research and factories during downturns to take advantage of upturns -- and it became hugely profitable. Samsung became more open about its financial performance, announcing results quarterly and meeting investors more frequently. None of it has made a difference in Samsung's historical P/E.

That ratio now appears to be getting a lift from a force beyond the company's control -- the rise of a domestic-investor class.

Korean banks and employers last year began offering U.S.-style retirement plans, letting workers set aside a portion of their monthly earnings as long-term investments with tax benefits.

Korea's stock market rose 54% in 2005 as local investors poured more than $500 million a month into equities.

Samsung, the country's largest and most profitable company, has benefited. In early December, the shares topped their record of 637,000 won ($645.60), and they ended 2005 at 659,000 won.

Friday, shares fell 2,000 won on the Korea Stock Exchange to 687,000 won, but they are up 4.2% this year. Samsung shares have been lifted this month by strong fourth-quarter results and the company's forecast that 2006 net income will be higher than 2005. There was another spur: A prominent analyst argued that the traditional method for valuing Samsung had outlived its usefulness and that the company's earnings multiple no longer should be assumed to be a discount to those of its peers.

For years, short-term movements in Samsung's shares have been shaped by the price-and-profit cycles of the company's biggest businesses -- semiconductors, liquid-crystal displays and cellphones. Then, Jan. 9, Simon Woo, an analyst at Merrill Lynch in Seoul, began a report by declaring Samsung "is no longer a cyclical stock." Investors should pay more attention to the company's ability to generate earnings than to swings in its operating margins, he said.

Samsung's rapid sales increases have allowed it to overcome swings in divisional operating margins and generate more profit, Mr. Woo said. Since the tech industry's last peak year in 2000, Samsung has earned more per share each year, with the exception of 2001, when the tech bubble burst and earnings suffered industrywide.

In an interview, Mr. Woo agreed his report's opening statement was provocative. "It might be better to say Samsung is less cyclical," he said. "For the short term, there's still earnings volatility. When you measure more than a one-year period, it shows no more cyclical pattern."

In his report, Mr. Woo replaced his target price of 720,000 won with a new objective of 910,000 won, which he expects Samsung shares to reach in the next 12 months. That level implies a long-term average P/E ratio of 15, well above the historical average of 10.

Henry Seggerman, president of International Investment Advisers, a New York firm that manages Korea-focused mutual funds, said he believes Samsung needs to get a listing outside Korea and take other steps to lift its P/E to the level of its global peers. He shares Mr. Woo's view that the multiple is beginning that climb. "There's no reason for it to be trading at its current valuation other than the longstanding tradition of it trading at that valuation," Mr. Seggerman said.

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At times, bullishness about Samsung has been risky. In April 2004, after Samsung had a record $3.1 billion of net income, several analysts raised the prospect that its shares -- then at a record 637,000 won -- would reach one million won. Within weeks, the shares started tumbling, as memory chips and LCDs began sharp downturns in their pricing cycles. The share-price eventually drifted below 400,000 won before turning upward again in late 2004.

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Today, Samsung's cyclical businesses are experiencing upturns. The chip operation is roaring ahead as the company tries to keep up with demand for NAND flash-memory chips in digital-music players, cameras and portable-game machines. In the fourth quarter, Samsung's chip business accounted for 76% of operating profit and 33% of revenue.

D.J. Yook, an analyst at Deutsche Bank in Seoul, says he is considering a 52-week price target as Samsung shares near his 723,000 won target. "Positive surprises are more likely than negative," he says.

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