

Unprecedented supply cuts to boost Samsung, SK

Last year was disastrous for Samsung Electronics and SK Hynix in terms of profits from memory chips due to an unprecedented steep downturn that resulted in all semiconductor manufacturers reducing spending and production capacity.

But this year is expected to be different as massive supply cuts start to have an effect on the overall industry as demand rebounds to restock inventories. This is anticipated to stabilize prices of both DRAM and NAND chips throughout the year.

Samsung Electronics has the largest share of the global market for DRAMs, which is used in all digital devices, followed by the SK Group affiliate. Samsung is also the largest supplier of NAND-type chips used in value-added consumer products and corporate servers.

However, their profitability is dependent upon the semiconductor price curve with macroeconomic factors affecting overall supply and demand structures.

"Following worse-than-expected oversupply in 2019, we forecast significant DRAM undersupply in 2020. We see a tight situation in 2020 due to the severe supply cuts in 2019," Bernstein Research, a top-tier U.S.-based independent research firm, said in a recent note to clients. It added that the Korean tech heavyweights would be the top beneficiaries in increased memory industry revenue.

Inventory levels at the leading memory chip suppliers are well on the way to normalization - Samsung's DRAM inventory is around the normal level of 10 to 20 days, down from an estimated five weeks as of the first quarter of last year.

Similarly, SK's DRAM and NAND inventory has also improved since peaking at a respective six and nine weeks in the first half of last year, to five and six weeks as of the

third quarter of last year.

Despite such a positive outlook, Samsung and SK are "very unlikely" to increase spending on manufacturing because all players in the industry are actively pursuing "rational behavior" as profitability is still healthy. For further effective inventory control, SK, which has a greater exposure in DRAMs rather than NAND chips, is anticipated to cut spending this year to below 10 trillion won.

The key factor making the NAND segment rosy is smartphones continuing to dominate the embedded product segment with healthy demand coming from content growth as well as data expansion supported by data-driven firms such as Facebook, Amazon, Netflix and Google, collectively known as FANG.

Given these factors, visible additional upsides are widely expected for Samsung Electronics and SK Hynix stocks on the Seoul bourse. Key risk factors would be currency appreciation and a possible sell-off in South Korea and Asian equities – all non-industry related considerations.

Samsung electronics is expected to be traded at 65,000 won and 73,000 won per share throughout 2020, while stocks will move from 115,000 won to 151,000 won.