

Samsung: It's About Big Profits, Not Big News

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Samsung produces more smartphones than any other company, including one model last year that spontaneously caught fire. Those incendiary Galaxy Note 7s were soon recalled and replaced...with more phones that spontaneously caught fire. Airlines cautioned passengers about the hazards of using their old *and* new Samsung phones, and Samsung stock plummeted.

But even a defective—and worse—dangerous product didn't erode our confidence in Samsung's long-term performance, as I wrote in [October 2016](#). Phones are just a small part of this thriving industrial conglomerate, and its stock hasn't just bounced back. It has catapulted, increasing 90% (calculated in U.S. dollars) over the last year.

We're happy about this, of course, as we continue to hold Samsung in our funds. But such stellar performance is also an important reminder of the right way to approach investing: with the goal of always knowing what you're investing in and why.

Disaster never looked so good

If smartphones were Samsung's only business, last year's events might have severely damaged the whole operation. But taken in context, it's easy to understand the minimal impact of the auto-exploding Galaxy Note 7 (and its replacement).

In addition to smartphones, Samsung also makes more memory chips than anyone else. (Intel is the second largest producer; Taiwan Semiconductor is the third.) Its OLED (organic light emitting diode) panels, which are used in iPhones, generate significant revenue, too—as do other electronic products like washing machines, vacuum cleaners, and televisions.

And the demand for technology in the global economy just keeps growing. Look at the technology built into today's cars, for example. The demand for the most recent Galaxy Note 8 has contributed to Samsung's strong third quarter earnings. Sales were up 12%, but margin improvement is the real driver behind the increase in stock price. The company is more profitable now than it was.

But South Korea is still an emerging market, which is probably why Samsung— representing a significant proportion of South Korea’s GDP—still trades at a relative discount: eight times forward earnings. For comparison, LG trades at 9.4x, Intel at 14x, and Apple at 15x.

Think before you act

Investors who made decisions based on the news cycle might have run screaming from Samsung at the first whiff of burning plastic. And what a mistake that would have been.

A closer look at the company and its component businesses, as well as how they fit into the economy, was all it took for us to appreciate that episode for what it was: a short-term setback.

This kind of insightful analysis drives all of our investment decisions, whether we are evaluating a single ailing stock or a broader downturn in the economy. The latter is bound to happen sooner or later, and plenty of explanations—It’s the president! It’s run-away inflation!—will be offered when it does.

But armed with a true understanding of the company we’ve bought into, how it works, why it makes money—we won’t need simple explanations. We will still be able to gauge whether an investment will continue to provide returns, and act accordingly.

Proof in the pudding

Samsung was in the news again recently, this time for a leadership reshuffle: Oh-Hyun Kwon has stepped down as Vice Chairman, Board Chairman and member as well as CEO of Samsung Display; and former CEO Jay Y. Lee has been sentenced to 5 years in jail for corruption.

It doesn’t sound great. But, AGF, one of our sub-advisors in the MD Growth Fund and the MD Fossil Fuel Free Equity Fund, isn’t worried: “Samsung has a strong management team with strong bench strength. Overall, we expect that Samsung will sustain and grow over the long term, supported by its stable margins and rising asset turns.”

And in fact, the so-called “leadership vacuum” hasn’t had any negative effects on stock prices so far.

We hold Samsung in various funds and pools at weights over 3% because we fully grasp this robust company’s potential for growth. So its continued resilience really isn’t news to me.