

Hyundai Hysco (010520 KS)

Steel

A beneficiary of the steel market slump

2Q Review: Sales volume growth drove earnings improvement

For 2Q, Hyundai Hysco posted revenues of W2.22tr (up 5.5% QoQ) and an operating profit of W122.9bn (up 6.5% QoQ) under consolidated K-IFRS. The operating profit figure was in line with the consensus (W129.8bn). We attribute the company's QoQ earnings improvements to the fact that the sales volumes of cold-rolled coils (CRC) and steel pipes jumped by 13.2% QoQ and 14.3% QoQ, respectively, on strong seasonality. In particular, despite the company's automotive CRC price cuts, automotive steel margin deterioration was only minimal thanks to a drop in hot-rolled coil (HRC; a raw material) prices. Furthermore, steel pipe export prices were high thanks to strong oil prices.

However, in 3Q, the company's sales volume is likely to decline in light of weak seasonal demand. And steel pipe export margins should contract on oil price drops. As such, we project Hyundai Hysco's 3Q consolidated operating profit to slide 7.3% QoQ to W114bn. Meanwhile, Hyundai Hysco's 2Q net profit plunged 25.0% QoQ, as F/X translation losses at overseas subsidiaries expanded on won depreciation.

A possible alternative to other steel shares before the market recovers

With the steel market slowing, Hyundai Hysco could become a viable alternative to other sluggish steel shares, as the company boasts strong earnings stability despite the steel market slump. While the HRC segment is facing oversupply due to the slump, the company's automotive steel margins have stayed high on the back of strong auto sales at the Hyundai-Kia Automotive Group.

Automotive steel accounts for 57% of Hyundai Hysco's revenues. The company's automotive steel unit generates an OP margin of 9~10%, which seems sufficient to offset profit deterioration at general CRC products and pipe units. However, because global steelmakers are expanding their automotive steel capacity (to capitalize on the solid margins of related products), automotive steel margins are unlikely to further expand over the long term. Still, it should be noted that these margins are unlikely to plunge in the short term. Thus, buying Hyundai Hysco's shares could be an alternative strategy for investing in the steel sector before the steel market picks up.

Meanwhile, we anticipate Hyundai Hysco to enter a second phase of growth following the completion of its second CRC factory (scheduled for May 2013). We project the company's CRC sales volume to expand to 4.975mn tonnes (up 7.6%) in 2012, to 5.301mn tonnes (up 6.6%) in 2013, and to 5.951mn tonnes (up 12.3%) in 2014. This sales volume growth should ease concerns over potential margin deterioration, in our view.

► Earnings & Valuation Metrics

FY	Revenues (Wbn)	OP (Wbn)	OP Margin (%)	NP (Wbn)	EPS (Won)	EBITDA (Wbn)	FCF (Wbn)	ROE (%)	P/E (x)	P/B (x)	EV/EBITDA (x)
12/10	6,866	307	4.5	194	2,416	526	296	15.4	10.4	1.5	5.7
12/11	8,170	435	5.3	297	3,699	684	-39	19.9	9.5	1.8	5.7
12/12F	8,510	465	5.5	325	4,056	654	465	18.3	10.7	1.8	6.4
12/13F	8,619	447	5.2	343	4,270	698	90	16.4	10.1	1.6	5.9
12/14F	9,184	463	5.0	354	4,412	717	266	14.6	9.8	1.4	5.4

Note: All figures are based on consolidated K-IFRS; NP refers to net profit attributable to controlling interests
Source: Company data, KDB Daewoo Securities Research estimates

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Hold (Maintain)

Target Price (12M, W)	-
Share Price (07/24/12, W)	43,300
Expected Return (%)	0.0
EPS Growth (12F, %)	9.6
Market EPS Growth (12F, %)	16.4
P/E (12F, x)	10.7
Market P/E (12F, x)	9.2
KOSPI	1,793.93
Market Cap (Wbn)	3,473
Shares Outstanding (mn)	80
Avg Trading Volume (60D, '000)	207
Avg Trading Value (60D, Wbn)	8
Dividend Yield (12F, %)	0.6
Free Float (%)	44.0
52-Week Low (W)	31,650
52-Week High (W)	52,500
Beta (12M, Daily Rate of Return)	1.08
Price Return Volatility (12M Daily, %, SD)	2.9
Foreign Ownership (%)	22.1

Major Shareholder(s)

Hyundai Motor et al. (55.12%)

JFE Steel (Kawasaki Steel) (7.99%)

Price Performance

(%)	1M	6M	12M
Absolute	9.8	7.9	-18.2
Relative	12.7	15.9	-0.8

Key Business

Hyundai Hysco is an automotive steel supplier for the Hyundai-Kia Automotive Group. The company's products include automotive steel sheets, general CRC, and steel pipes.

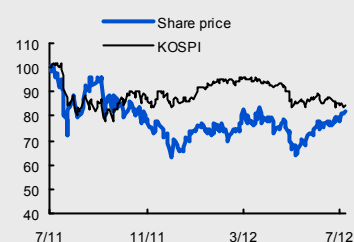


Table 1. Quarterly earnings outlooks for Hyundai Hysco

	2011					2012F					2Q12 Chg. %	
	1Q	2Q	3Q	4Q	FY	1Q	2QP	3QF	4QF	FY	QoQ	YoY
	Revenues	1,856	2,085	2,045	2,184	8,170	2,108	2,224	2,042	2,134	8,509	5.5
Operating profit	107	123	96	104	435	115	123	114	113	465	6.5	0.1
Pretax profit	100	119	90	73	382	114	95	104	102	414	-16.8	-20.5
Net profit	73	93	71	60	297	94	71	81	80	325	-24.7	-23.9
OP margin	5.7	6.1	4.7	4.8	5.3	5.5	5.5	5.6	5.3	5.5	-	-
Pretax margin	5.4	5.7	4.4	3.4	4.7	5.4	4.2	5.1	4.8	4.9	-	-
Net margin	3.9	4.4	3.5	2.7	3.6	4.4	3.2	4.0	3.7	3.8	-	-
F/X (US\$/W)	1,119	1,083	1,085	1,145	1,108	1,131	1,152	1,135	1,120	1,135	1.8	6.3

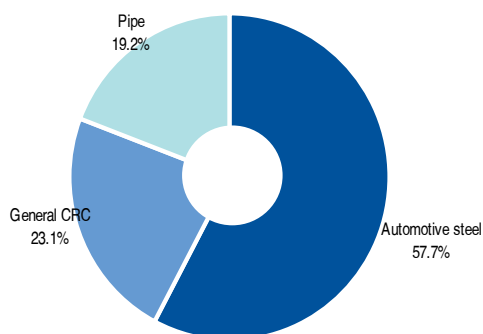
Source: Company data, KDB Daewoo Securities Research (based on consolidated K-IFRS)

Table 2. Earnings forecast revisions for Hyundai Hysco

		Previous		Revised		Chg. %	
		2012F	2013F	2012F	2013F	2012F	2013F
Earnings forecast	Revenues	8,592	8,608	8,510	8,619	-1.0	0.1
	Operating profit	450	442	465	447	3.4	1.1
	Pretax profit	422	431	415	440	-1.7	2.1
	Net profit	334	335	325	343	-2.7	2.1
	OP margin	5.2	5.1	5.5	5.2	-	-
	Pretax margin	4.9	5.0	4.9	5.1	-	-
	Net margin	3.9	3.9	3.8	4.0	-	-
Sales volume ('000 tonnes)	CRC	4,973	5,301	4,987	5,301	0.3	0.0
	Steel pipes	1,097	1,064	1,097	1,064	0.0	0.0
ASP (W'000/tonne)	CRC	1,159	1,140	1,152	1,142	-0.6	0.2
	Steel pipes	1,251	1,241	1,247	1,241	-0.3	0.0
Raw materials	HRC (W'000/tonne)	845	828	851	828	0.7	0.0
F/X	US\$/W (average)	1,098	1,050	1,135	1,050	3.3	0.0
	US\$/W (ending)	1,050	1,000	1,100	1,000	4.8	0.0

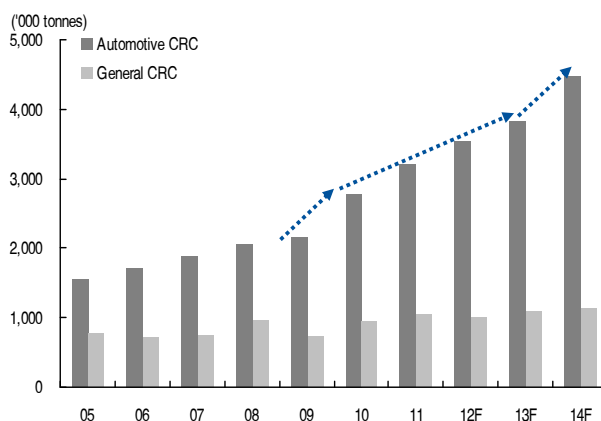
Source: Company data, KDB Daewoo Securities Research (based on consolidated K-IFRS)

Figure 1. Sales breakdown for 2012



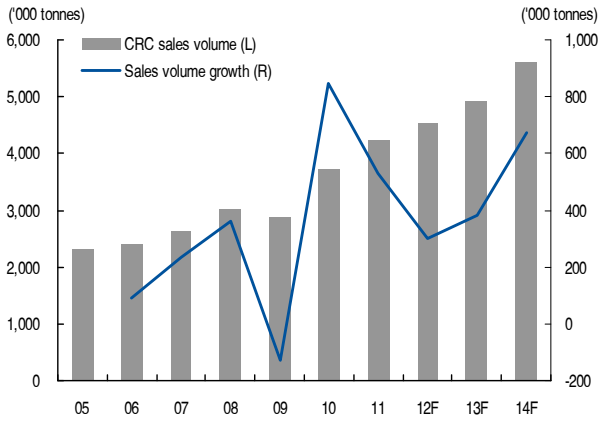
Source: Company data, KDB Daewoo Securities Research

Figure 2. Sales volume of automotive steel is steadily growing



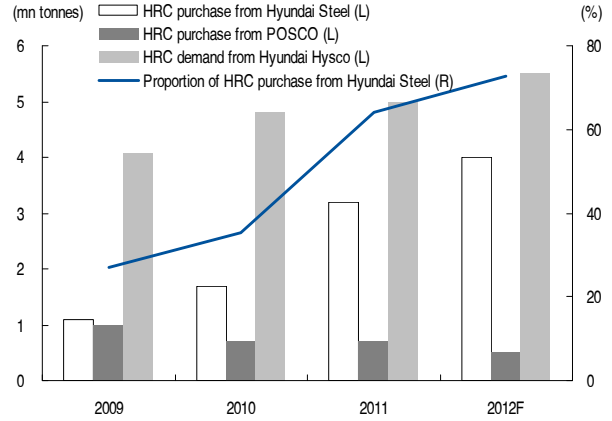
Source: Company data, KDB Daewoo Securities Research

Figure 3. CRC sales volume is set to surge again from 2013



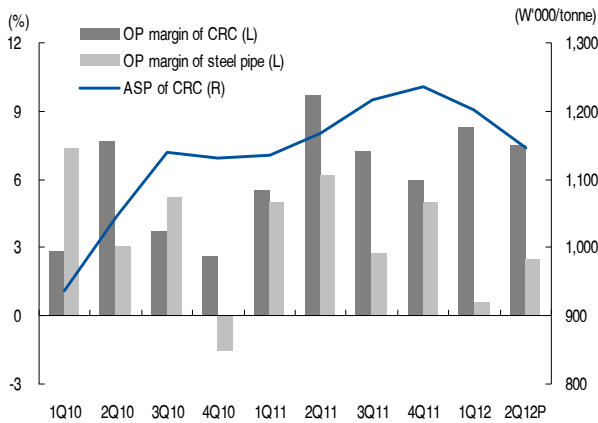
Source: Company data, KDB Daewoo Securities Research

Figure 4. Hyundai Steel accounts for 70% of Hyundai Hysco's HRC purchases



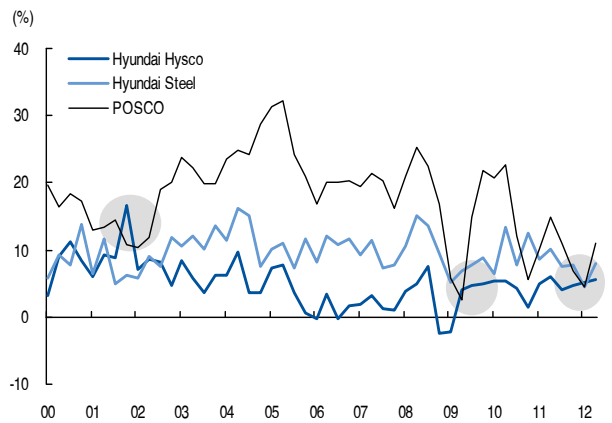
Source: Company data, KDB Daewoo Securities Research

Figure 5. Solid CRC margin despite drop in ASP



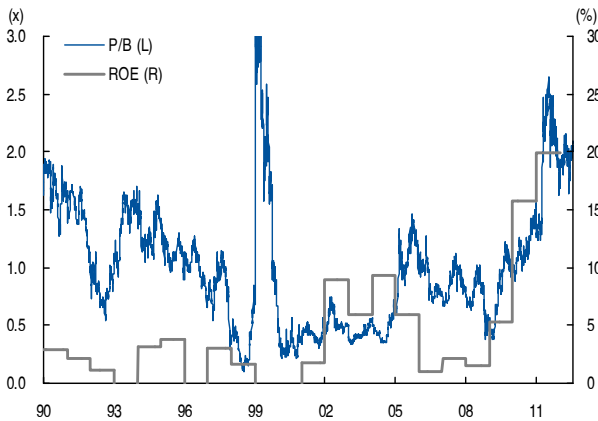
Source: Company data, KDB Daewoo Securities Research

Figure 6. OP margin exceeded that of blast furnace operators



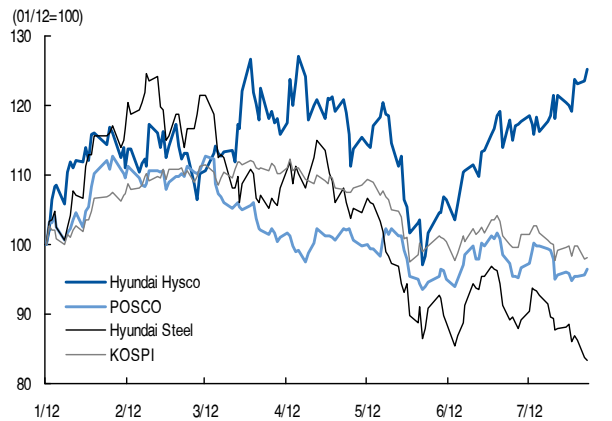
Source: Company data, KDB Daewoo Securities Research

Figure 7. P/B-ROE of Hyundai Hysco



Source: Thomson Reuters, KDB Daewoo Securities Research

Figure 8. Shares have outperformed BF operators since June



Source: Thomson Reuters, KDB Daewoo Securities Research

Hyundai Hysco (010520 KS/Hold)

Comprehensive Income Statement (Summarized)				
(Wbn)	12/11	12/12F	12/13F	12/14F
Revenues	8,170	8,510	8,619	9,184
Cost of Sales	7,461	7,755	7,879	8,420
Gross Profit	709	755	740	764
SG&A Expenses	276	302	295	298
Operating Profit (Adj)	433	453	446	466
Operating Profit	435	465	447	463
Non-Operating Profit	-53	-50	-7	-8
Net Financial Income	37	42	23	21
Net Gain from Inv in Associates	0	0	0	0
Pretax Profit	382	415	440	455
Income Tax	84	89	97	100
Profit from Continuing Operations	298	326	344	355
Profit from Discontinued Operations	0	0	0	0
Net Profit	298	326	344	355
Controlling Interests	297	325	343	354
Non-Controlling Interests	1	0	1	1
Total Comprehensive Profit	300	326	344	355
Controlling Interests	298	325	342	354
Non-Controlling Interests	1	1	1	1
EBITDA	684	654	698	717
FCF (Free Cash Flow)	-39	465	90	266
EBITDA Margin (%)	8.4	7.7	8.1	7.8
Operating Profit Margin (%)	5.3	5.5	5.2	5.0
Net Profit Margin (%)	3.6	3.8	4.0	3.9

Statement of Financial Condition (Summarized)				
(Wbn)	12/11	12/12F	12/13F	12/14F
Current Assets	2,726	3,217	3,294	3,670
Cash and Cash Equivalents	447	990	1,038	1,266
AR & Other Receivables	1,076	1,051	1,065	1,134
Inventories	1,190	1,163	1,178	1,255
Other Current Assets	13	13	13	14
Non-Current Assets	1,994	1,905	2,164	2,224
Investments in Associates	3	7	7	7
Property, Plant and Equipment	1,843	1,750	2,000	2,050
Intangible Assets	41	40	38	37
Total Assets	4,721	5,122	5,458	5,893
Current Liabilities	2,565	2,467	2,486	2,585
AP & Other Payables	1,442	1,409	1,427	1,521
Short-Term Financial Liabilities	1,031	968	968	968
Other Current Liabilities	92	90	91	97
Non-Current Liabilities	522	717	710	710
Long-Term Financial Liabilities	488	674	674	674
Other Non-Current Liabilities	20	24	17	18
Total Liabilities	3,087	3,183	3,196	3,296
Controlling Interests	1,628	1,933	2,255	2,589
Capital Stock	401	401	401	401
Capital Surplus	269	269	269	269
Retained Earnings	967	1,273	1,595	1,929
Non-Controlling Interests	6	6	8	9
Stockholders' Equity	1,634	1,939	2,263	2,598

Cash Flows (Summarized)				
(Wbn)	12/11	12/12F	12/13F	12/14F
Cash Flows from Op Activities	504	549	591	569
Net Profit	298	326	344	355
Non-Cash Income and Expense	422	330	354	363
Depreciation	250	200	250	250
Amortization	2	2	2	2
Others	-87	-1	9	9
Chg in Working Capital	-153	-33	-10	-49
Chg in AR & Other Receivables	-80	25	-14	-70
Chg in Inventories	-281	30	-15	-77
Chg in AP & Other Payables	231	-42	18	94
Income Tax Paid	-64	-74	-97	-100
Cash Flows from Inv Activities	-534	-93	-456	-253
Chg in PP&E	-511	-107	-500	-300
Chg in Intangible Assets	-6	-1	0	0
Chg in Financial Assets	-27	-1	0	0
Others	10	16	45	47
Cash Flows from Fin Activities	35	86	-87	-87
Chg in Financial Liabilities	101	147	0	0
Chg in Equity	0	0	0	0
Dividends Paid	-20	-20	-20	-20
Others	-47	-61	-67	-67
Increase (Decrease) in Cash	5	542	49	228
Beginning Balance	442	447	990	1,038
Ending Balance	447	990	1,038	1,266

Forecasts/Valuations (Summarized)				
	12/11	12/12F	12/13F	12/14F
P/E (x)	9.5	10.7	10.1	9.8
P/CF (x)	5.1	6.6	5.9	5.7
P/B (x)	1.8	1.8	1.6	1.4
EV/EBITDA (x)	5.7	6.4	5.9	5.4
EPS (W)	3,699	4,056	4,270	4,412
CFPS (W)	6,832	6,565	7,408	7,549
BPS (W)	19,789	23,601	27,642	31,823
DPS (W)	250	250	250	250
Payout ratio (%)	6.7	6.1	5.8	5.6
Dividend Yield (%)	0.7	0.6	0.6	0.6
Revenue Growth (%)	19.0	4.2	1.3	6.6
EBITDA Growth (%)	30.0	-4.4	6.7	2.8
Operating Profit Growth (%)	41.8	6.8	-3.8	3.6
EPS Growth (%)	53.1	9.7	5.3	3.3
Accounts Receivable Turnover (x)	8.7	8.3	8.5	8.7
Inventory Turnover (x)	7.8	7.2	7.4	7.6
Accounts Payable Turnover (x)	7.7	7.2	7.3	7.5
ROA (%)	6.9	6.6	6.5	6.3
ROE (%)	19.9	18.3	16.4	14.6
ROIC (%)	13.8	13.7	13.1	12.8
Liability to Equity Ratio (%)	189.0	164.2	141.2	126.9
Current Ratio (%)	106.3	130.4	132.5	142.0
Net Debt to Equity Ratio (%)	65.6	33.6	26.7	14.5
Interest Coverage Ratio (x)	8.7	7.4	6.6	6.9

Source: Company data, KDB Daewoo Securities Research estimates

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	Hold	Relative performance of -10% and 10%	
	Sell	Relative performance of -10%	
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	Neutral	Fundamentals are steady without any material changes	
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