

Holding Companies (Overweight)

Holding companies deserve re-rating

Overweight: Valuation discounts to dissipate

We initiate coverage of the holding company sector with an Overweight rating. Holding companies' shares are undervalued relative to their net asset values because investors prefer to directly invest in blue chip subsidiaries capable of generating more cash. But we believe valuation discounts will dissipate over time as: 1) the government should continue to ease the rules governing the founding and operations of holding companies, and 2) unlisted subsidiaries with robust growth potential should help boost NAV growth.

Core subsidiaries perform far better than before

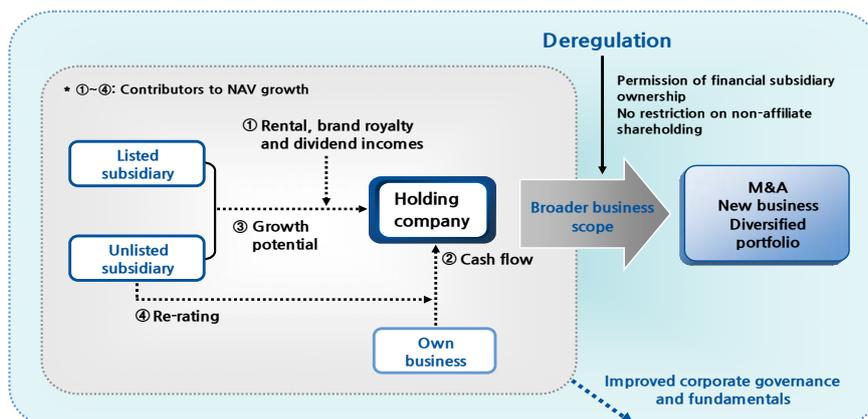
The earnings, business stability and growth potential of holding companies' core subsidiaries have improved markedly in recent years. Moreover, holding companies have diversified their revenue sources to include brand royalties and rental incomes, in addition to dividend payments from subsidiaries. As a result, their earnings volatility has decreased and fundamentals have improved.

Top picks: LG Corp. and SK Holdings

Our top picks are LG Corp. (003550 KS) and SK Holdings (003600 KS), which were selected based on the following criteria: ① Subsidiary portfolio: Growth potential of core subsidiaries, and re-rating of unlisted subsidiaries. ② Stable corporate governance: Synergies among related businesses within the group, and willingness to enter new businesses. ③ Attractive valuation: Undervalued stocks (compared to NAV), and possible declines in valuation discounts thanks to deregulation.

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New business opportunities for holding companies following regulatory changes



Source: Daewoo Securities Research

Please read carefully important disclosures at the end of this report.

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I. Investment summary

1. Investment strategies

Investment strategies:

- 1) NAV growth = Valuation of subsidiaries
- 2) Decline in discount rates = Deregulation

Investors interested in holding companies should examine the valuation methods for such companies.

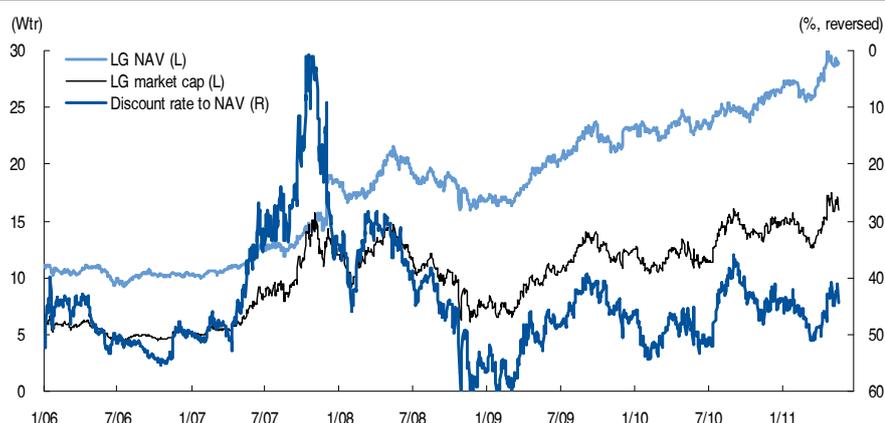
First, can NAV increase?

A holding company's share price fluctuates in line with changes in its net asset value (NAV). NAV mostly reflects the value of the holding company's listed and unlisted subsidiaries. Thus, core subsidiaries should be selected, and their impacts on the holding company's NAV should be analyzed in view of their growth potential. In particular, as unlisted subsidiaries with robust growth potential can greatly contribute to NAV growth, it is important to objectively estimate the market values of such companies (i.e., comparison with listed peers vs. the traditional book value-based valuation).

Second, can valuation discounts decline?

We anticipate that valuation discounts applied to holding companies will decline in line with government deregulations on business portfolios (revisions to the Monopoly Regulation and Fair Trade Act). Holding companies have been undervalued, because: 1) investors prefer to directly invest in blue chip companies than through holding companies; 2) holding companies tend to generate low cash flows (dividend incomes are their main source of revenue); and 3) holding companies are exposed to high risks compared to their subsidiaries, as they assume responsibilities for new projects and/or businesses conducted at the group level.

Figure 1. NAV and market cap move in tandem



Source: Daewoo Securities Research

2. Valuation

1) Valuation method

Most commonly used valuation method = Sum-of-the-parts methodology

The most commonly used valuation method for holding companies is sum-of-the-parts analysis.

A holding company usually holds equity stakes in a variety of subsidiaries, and thus, valuations are based on the sum of the company’s investment securities in each subsidiary. Moreover, rental incomes and brand royalties are also reflected, as holding companies typically lease office buildings to their subsidiaries, and license their brands in return for royalties. A holding company’s valuation is comprised of the following three components:

Value of listed subsidiaries

The fair value of listed subsidiaries can be easily obtained from the market at any given time. As such, we used the market cap of listed subsidiaries, multiplied by the holding company’s shareholding ratio, to calculate the NAV of listed subsidiaries.

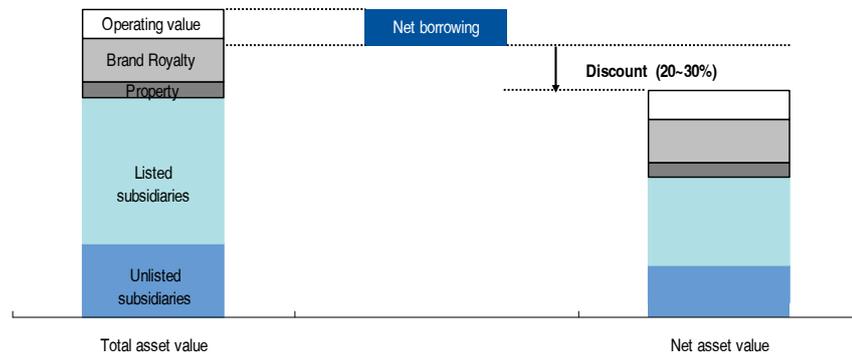
Value of unlisted subsidiaries

The fair value of unlisted subsidiaries cannot be easily obtained, and thus, we used the book value of equity capital (as recorded on the most recently-released financial statements). However, for unlisted subsidiaries whose sales and earnings are expected to have a significant impact on the holding company’s NAV, or if their peers are already listed and traded publicly on the market, we applied multiples calculated as appropriate.

Value of non-operating assets

The present value of rental income is equivalent to the fair values of the holding company’s land and property. Moreover, a discounted cash flow method was used to calculate the value of brand royalties.

Figure 2. Valuation method of a holding company



Source: Daewoo Securities Research

Korean holding companies are undervalued despite the growth potential of core subsidiaries and their diversified revenue sources

3. Korean holding companies seem undervalued

We believe that the shares of Korean holding companies are undervalued. The earnings, business stability and growth potential of their core subsidiaries have improved markedly in recent years. Moreover, holding companies have diversified their revenue sources to include brand royalties and rental incomes, in addition to dividend payments from subsidiaries. As a result, earnings volatility has decreased and fundamentals have improved. However, their shares have yet to reflect such positive developments.

Table 1. Valuation comparison

	LG	SK	Doosan	(Wbn) Hanwha
1. Present values of future income				
Operating value	-	-	1,649	2,007
Brand royalty	2,735	2,414	264	-
Rental income	1,171	-	170	151
Total	3,906	2,414	2,084	2,158
2. Investment asset value				
Listed subsidiaries	20,599	12,312	2,567	4,015
Unlisted subsidiaries	5,810	4,913	721	1,534
Total	26,408	17,225	3,288	5,549
3. Total asset value	30,314	19,639	5,372	7,707
4. Net borrowing	-76	3,061	212	1,907
5. NAV	30,390	16,578	5,160	5,799
No. of shares ('000)	175,756	40,987	23,071	69,558
NAV per share (W)	172,910	404,471	223,657	83,371
6. Target Price (W)	130,000	280,000	180,000	63,000
Current price (W)	89,000	207,500	125,000	46,450
Discount rate (%)	48.5	48.7	44.1	44.3
Upside potential (%)	46.1	34.9	44	35.6

Source: Daewoo Securities Research

4. Overweight the sector; Top picks are LG Corp. and SK Holdings

Overweight rating

Top picks:

*LG Corp. (003550 KS)
and SK Holdings
(003600 KS)*

We initiate coverage of the holding company sector with an Overweight rating. Our top picks are LG Corp. (003550 KS) and SK Holdings (003600 KS), which were selected based on the following criteria:

- ① Subsidiary portfolio: Growth potential of core subsidiaries, and re-rating of unlisted subsidiaries
- ② Stable corporate governance: Synergies among related businesses within the group, and willingness to enter new businesses
- ③ Attractive valuation: Undervalued stocks (compared to NAV), and possible declines in valuation discounts thanks to deregulation

LG Corp.'s future growth should be driven by its electronics and chemicals businesses, and some of its unlisted subsidiaries are leaders in their respective industries. Moreover, the company benefits from stable corporate governance, as several years have passed since the introduction of the holdings structure. Furthermore, steady cash flows should enable the company to expand into new businesses and create synergies within the group.

SK Holdings has exhibited continuous growth led by its energy and telecommunication businesses. The company also actively searches for opportunities to enter new markets. Since restrictions on holding companies' business activities will be lifted, we expect SK Holdings' share price volatility to decline and its corporate value to rise further.

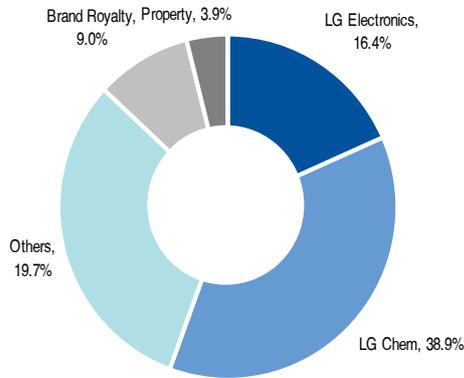
Both LG Corp. and SK Holdings are subject to excessively steep valuation discounts (compared to their respective NAVs), and thus, appear significantly undervalued.

Table 2. Valuation table

		LG Corp. (003550 KS)	SK Holdings (003600 KS)	Doosan Corp. (000150 KS)	Hanwha Corp. (000880 KS)
Rating		Buy	Buy	Buy	Buy
Target price (₩)		130,000	280,000	180,000	63,000
Current price (₩)		89,000	207,500	125,000	46,450
Upside potential (%)		46.1	34.9	44.0	35.6
EPS	12/09	8,747	5,988	7,598	7,443
(₩)	12/10	2,394	13,622	8,536	3,638
	12/11F	2,427	24,205	10,931	5,535
	12/12F	2,728	28,051	11,999	5,931
	12/13F	2,894	29,864	16,344	6,206
BPS	12/09	8,747	5,988	7,598	7,443
(₩)	12/10	2,394	13,622	8,536	3,638
	12/11F	2,427	24,205	10,931	5,535
	12/12F	2,728	28,051	11,999	5,931
	12/13F	2,894	29,864	16,344	6,206
P/E	12/09	8.3	14.9	12.6	6.4
(x)	12/10	36.5	10.2	18.0	12.8
	12/11F	36.7	8.6	11.4	8.4
	12/12F	32.6	7.4	10.4	7.8
	12/13F	30.7	6.9	7.6	7.5
P/B	12/09	1.7	0.6	1.6	1.6
(x)	12/10	2.2	0.9	2.4	1.3
	12/11F	2.2	1.2	1.7	1.1
	12/12F	2.1	1.0	1.5	1.0
	12/13F	2.0	0.9	1.3	0.9
ROE	12/09	22.6	4.1	13.7	27.7
(%)	12/10	5.9	8.8	13.6	10.6
	12/11F	6.0	14.2	15.5	13.6
	12/12F	6.5	14.4	15.1	12.9
	12/13F	6.6	13.5	17.9	12.1
Operating profit	12/09	1,588	372	-65	235
(Wbn)	12/10	475	903	253	243
	12/11F	489	1,548	381	224
	12/12F	550	1,769	418	247
	12/13F	583	1,874	570	256
OP margin	12/09	89.9	48.5	-6.8	5.0
(%)	12/10	80.4	70.9	16.5	4.7
	12/11F	80.9	81.8	19.4	4.1
	12/12F	80.4	84.7	18.1	4.4
	12/13F	80.5	85.2	20.8	4.3
Net profit	12/09	1,538	284	232	561
(Wbn)	12/10	421	647	262	274
	12/11F	427	1,149	337	418
	12/12F	480	1,332	370	447
	12/13F	509	1,418	504	468
EBITDA	12/09	1,615	378	-24	281
(Wbn)	12/10	484	909	295	289
	12/11F	490	1,554	431	266
	12/12F	550	1,775	461	285
	12/13F	583	1,879	606	290
EV/EBITDA	12/09	7.9	18.4	-113.3	19.7
(x)	12/10	31.2	10.6	14.8	18.8
	12/11F	31.6	8.2	8.1	20.3
	12/12F	28.1	7.2	7.2	19.4
	12/13F	26.5	6.8	5.2	19.5

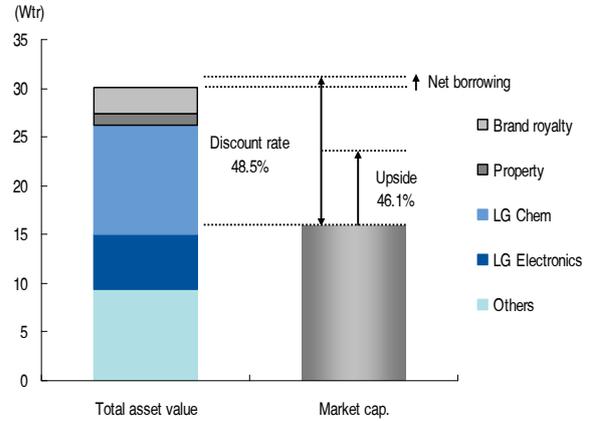
Source: Daewoo Securities Research

Figure 3. Contribution to LG Corp.'s NAV



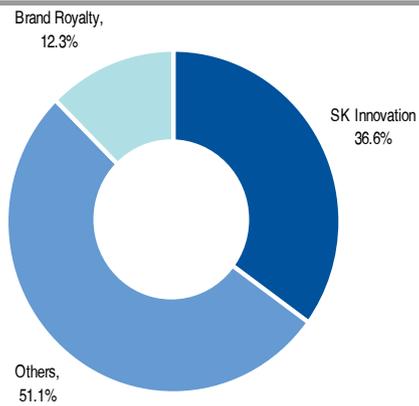
Source: Daewoo Securities Research

Figure 4. LG Corp.'s NAV breakdown



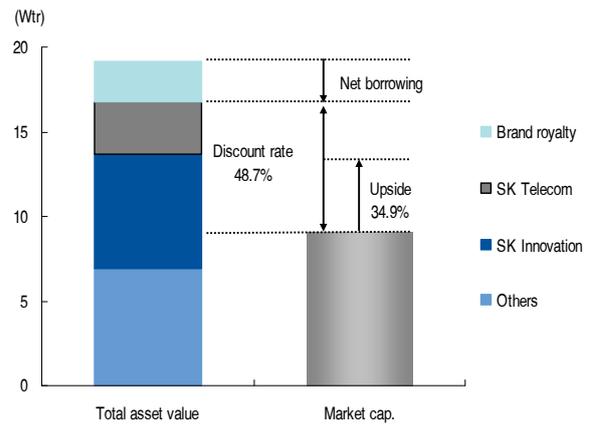
Source: Daewoo Securities Research

Figure 5. Contribution to SK Corp.'s NAV



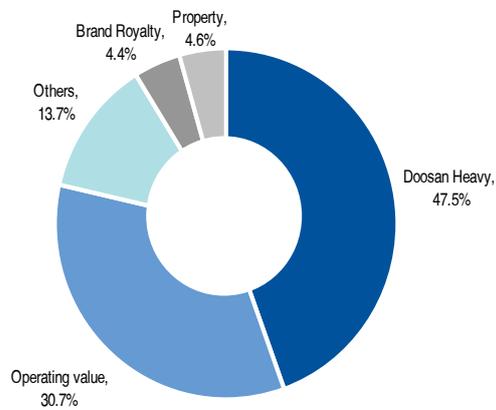
Source: Daewoo Securities Research

Figure 6. SK Corp.'s NAV breakdown



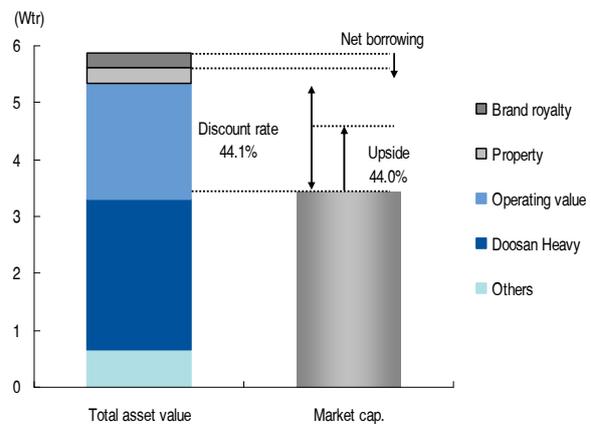
Source: Daewoo Securities Research

Figure 7. Contribution to Doosan Corp.'s NAV



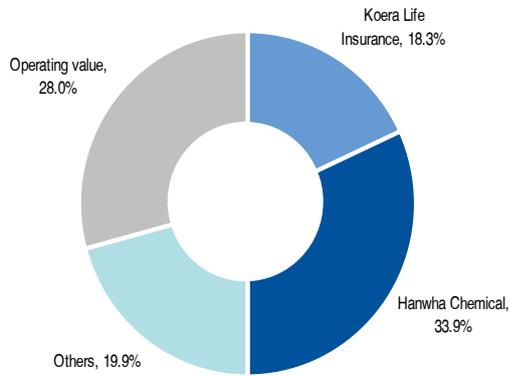
Source: Daewoo Securities Research

Figure 8. Doosan Corp.'s NAV breakdown



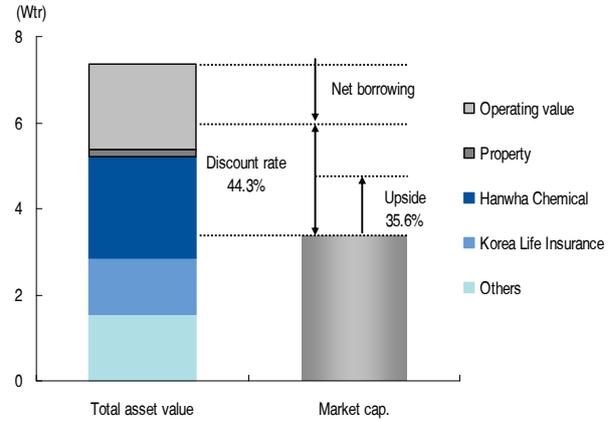
Source: Daewoo Securities Research

Figure 9. Contribution to Hanwha Corp.'s NAV



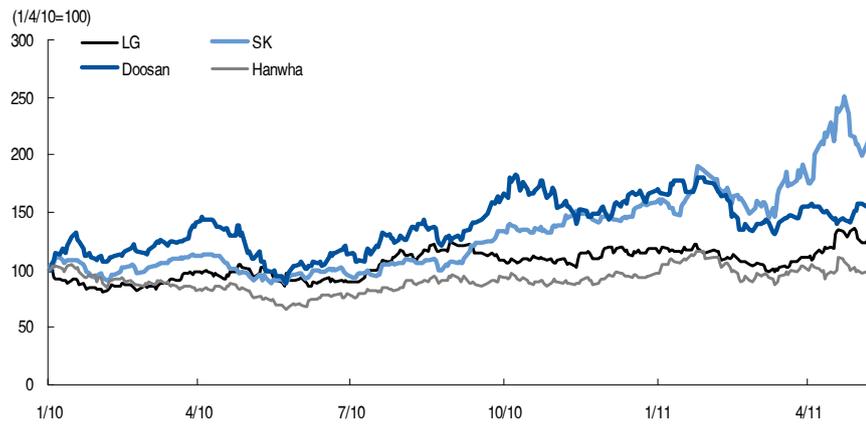
Source: Daewoo Securities Research

Figure 10. Hanwha Corp.'s NAV breakdown



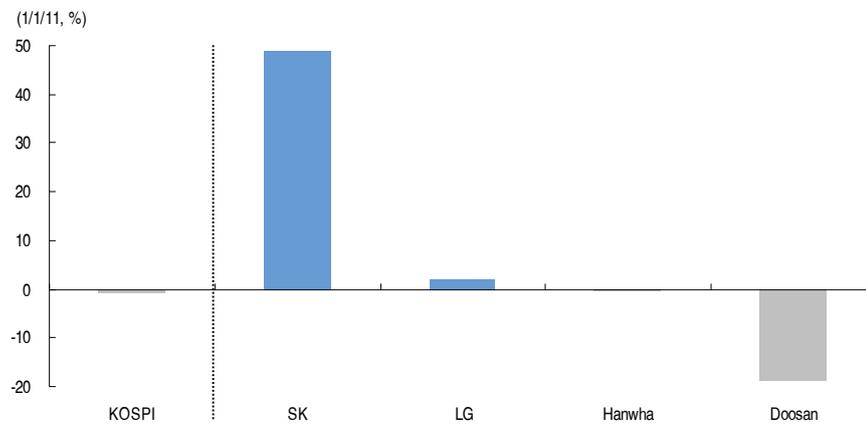
Source: Daewoo Securities Research

Figure 11. Relative share performances of holding companies in Daewoo Universe



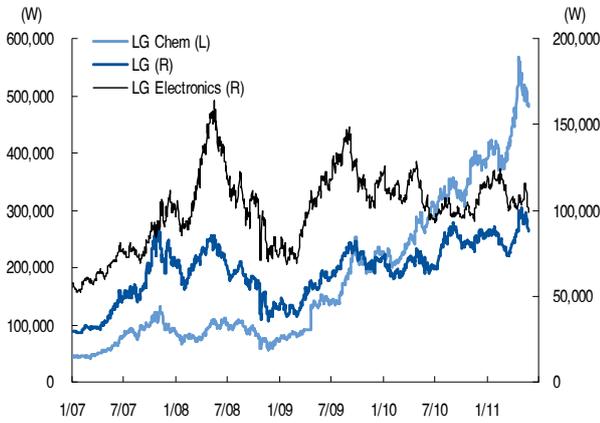
Source: Daewoo Securities Research

Figure 12. Comparison of share price growth



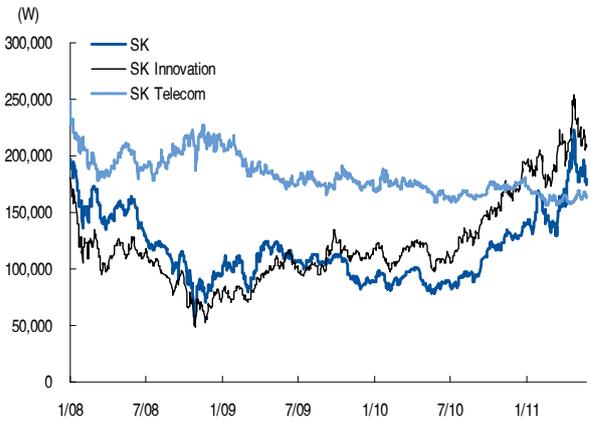
Source: Daewoo Securities Research

Figure 13. Share performances of LG Corp. and its core subsidiaries



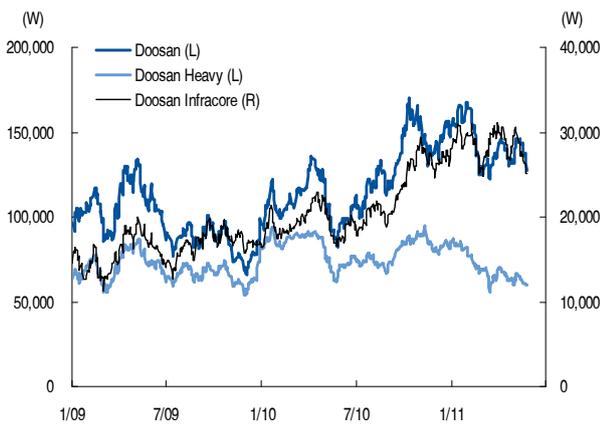
Source: Daewoo Securities Research

Figure 14. Share performances of SK Holdings and its core subsidiaries



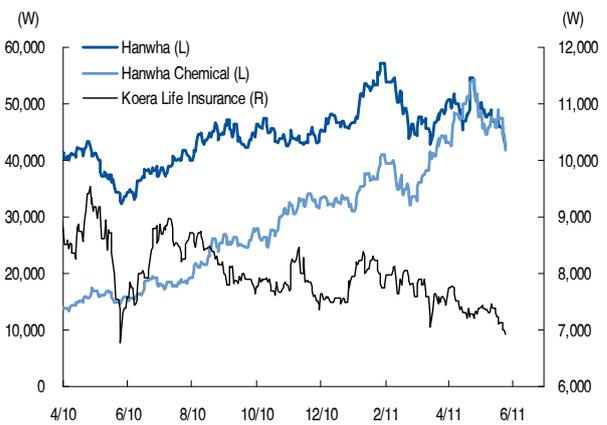
Source: Daewoo Securities Research

Figure 15. Share performances of Doosan Corp. and its core subsidiaries



Source: Daewoo Securities Research

Figure 16. Share performances of Hanwha Corp. and its core subsidiaries



Source: Daewoo Securities Research

II. Industry outlook

1. Holding companies

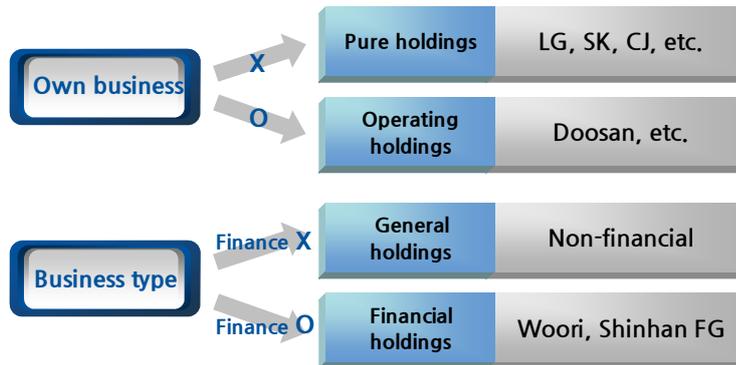
1) Definition

A holding company is a company that owns other companies' outstanding stocks, and controls the business activities of such companies.

Non-financial holding companies are subject to the MRFTA

The Monopoly Regulation and Fair Trade Act (MRFTA) in Korea does not differentiate between pure holding companies, which do not engage in businesses other than the management/control of subsidiaries, and operating holding companies, which also operate separate businesses. However, different regulations are applied to holding companies depending on the nature of subsidiaries' businesses (financial vs. non-financial holding companies). Non-financial holding companies are subject to the MRFTA, which prevents the excessive concentration of economic power by large conglomerates, and promotes transparency in business ownership. Financial holding companies are subject to both MRFTA and the Financial Holding Companies Act (FHCA).

Figure 17. Types of holding companies



Source: Daewoo Securities Research

2) Background of holding company structure

The holding company structure was prohibited under the MRFTA (first revision as of 1986) to prevent excessive concentration of economic power by conglomerates (*chaebols*). The government was concerned that the holding company structure would enable economically powerful conglomerates to control subsidiaries at only a small financial burden to the conglomerate.

In 1999, the MRFTA was revised to permit the establishment of holding companies

However, corporate restructuring became a necessity following the Asian financial crisis in 1997 (e.g., split-off/disposal of less competitive companies, injection of foreign capital into flagship businesses, and focus on profitable businesses). As a result, the benefits of the holding company structure—simple and transparent corporate governance, clear accountability for corporate management, and efficiency improvements through restructuring—became apparent. In 1999, the MRFTA was revised for the seventh time to permit the establishment of holding companies, albeit with numerous conditions.

Table 3. Factors to promote holding company structure

	Detail
Policy factors	Government determined to promote corporate reform and restructuring after the Asian financial crisis
Market factors	Growing influence of foreign investors in the domestic stock market Growing requests for transparent and profitability-focused corporate management
Corporate factors	Before the introduction of the holding company structure, companies struggled to restructure due to the existing legal backdrop; The new system facilitates efficient restructuring and tax benefits Holding company structure should improve management efficiency and enhance subsidiaries' competitiveness

Source: Daewoo Securities Research

Table 4. History of holding company structure

	Detail
1986	Prohibited the establishment and conversion to a holding company
1999	Establishment and conversion to a holding company was allowed with conditions Holding company's debt ratio should be below 100%; Stake in subsidiaries should exceed 50% Owning stakes in third-tier subsidiaries and beyond was prohibited
2000	Financial Holding Companies Act
2001	Requirement for stake ownership in listed subsidiaries was eased (50%→30%)
2004	Cross ownership between subsidiaries was prohibited; Requirement for stake ownership in second-tier subsidiaries was added (50% for unlisted, 30% for listed) Owning stakes over 5% in non-subsidiaries was prohibited
2006	Increased the rate of dividend exclusion from taxable income
2007	Requirements for stake ownership in subsidiaries and second-tier subsidiaries were eased (30%→20% for listed; 50%→40% for unlisted) Debt ratio requirement was eased (100%→200%) Requirement of business relationship between subsidiaries and second-tier subsidiaries was abolished; Owning stakes in third-tier subsidiaries was permitted (when a second-tier subsidiary owns a 100% stake in a third-tier subsidiary)
Present	MRFTA revision bill is pending in the National Assembly The bill will abolish the debt ratio requirement of 200% and the stake ownership limit of 5% in non-affiliates; The bill will extend the grace period from four to five years

Source: Daewoo Securities Research

3) Holding company conversion trend

96 Holding companies (as of end-September 2010)

96 Holding companies

As of end-September 2010, there were 96 holding companies that fulfilled the legal requirements under the MRFTA. In 2010, 24 new holding companies were established. However, seven companies, including Dream Pharma, which were previously considered holding companies, failed to meet the MRFTA requirements. Since the reintroduction of the holding company structure in February 1999, the number of holding companies has increased steadily.

Table 5. Current status of holding companies

	Holdings companies	Subsidiaries	Second-tier subsidiaries	Third-tier subsidiaries	Sum
General holdings	84 (46)	457 (100)	370 (22)	31 (0)	942 (168)
Financial holdings	12 (5)	73 (5)	53 (2)	7 (0)	145 (12)
Total	96 (51)	530 (105)	423 (24)	38 (0)	1,087 (180)

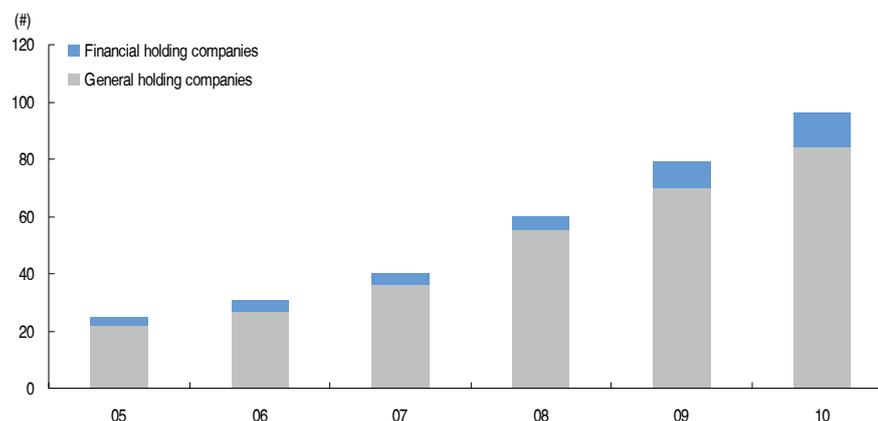
Source: Daewoo Securities Research

Table 6. Change in holding companies

	9/09/29	8/1/07~9/30/10			9/30/10
		Switch	Exclude	Total	
General holdings	70	21	7	14	84
Financial holdings	9	3	-	3	12
Total	79	24	7	17	96

Source: Daewoo Securities Research

Figure 18. Trend of the number of holding companies



Source: Daewoo Securities Research

2. Requirements and limitations

1) Requirements

Requirements to establish/convert to a holding company:

A company which wishes to convert into a holding company must fulfill the following requirements:

First, a holding company's assets should exceed W100bn.

Assets should exceed W100bn

Second, a holding company must own shares, as it controls other companies based on share ownership.

Third, a holding company can only control domestic subsidiaries. Even though a holding company can hold shares in affiliated companies overseas, the companies are not recognized as its subsidiaries. Companies that are established in partnership with foreign investors are recognized as subsidiaries, so long as they are based in Korea.

The combined value of subsidiary shares must exceed 50% of the holding company's asset value

Last, the combined value of subsidiary shares must exceed 50% of the holding company's asset value.

If a company meets all these aforementioned requirements, it is automatically considered a holding company and subject to applicable regulations.

Table 7. Requirements to establish/convert to a holding company

	Detail
Objective	To hold controlling stakes in domestic businesses
Total assets	Over W100bn
Stake	The combined value of subsidiary shares must exceed 50% of the holding company's asset value The share value is revised annually based on fair market value or equity method
Reporting	Within 30 days after the registration or merger/spilt-off day If a company converts to a holding company structure through stake acquisitions or asset growth, the company must report this change within four months after the end of the business year

Source: Daewoo Securities Research

2) Limitations on holding companies

Holding company must keep its debt ratio below 200%

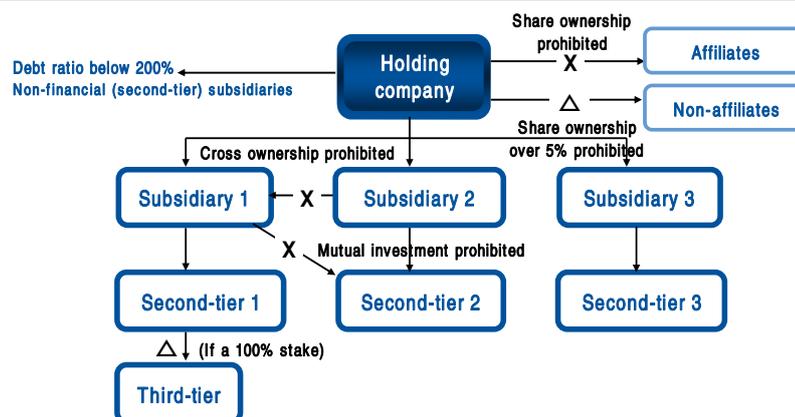
A holding company is required to keep its debt ratio below 200%, and its stakes in subsidiaries must exceed a certain percentage. A holding company cannot own 1) financial subsidiaries and 2) stakes in domestic companies that are not its subsidiaries. In addition, a holding company's subsidiary can only own shares in its second-tier subsidiaries (subsidiary's subsidiary), and its stakes must exceed a certain level.

Table 8. Major restrictions on holding companies under the current MRFTA

	MRFTA	Detail
Automatic conversion	Article 2	The combined value of subsidiary shares must exceed 50% of the company's asset value; Assets must exceed W100bn
Debt ratio	Article 8-2 (2)	A holding company's liabilities should not exceed twice the total amount of capital
Separation of the financial and industrial sectors	Article 8-2 (2), (3), (4)	A holding company is prohibited from owning stakes in financial subsidiaries, second-tier subsidiaries and third-tier subsidiaries
Prohibition of mutual investment	Article-2 (2)	A holding company is only allowed to own stakes in its subsidiaries; Its subsidiary are only allowed to own stakes in second-tier subsidiaries A subsidiary cannot own stakes in second-tier subsidiaries through mutual investments with other second-tier subsidiaries (or any additional parties)
Stakes in subsidiaries and second-tier subsidiaries	Article 8-2 (2)	A holding company's stake in listed and unlisted subsidiaries should exceed 20% and 40%, respectively A subsidiary's stake in listed and unlisted second-tier subsidiaries should exceed 20% and 40%, respectively
Third-tier subsidiary share ownership		In principle, a holding company is prohibited from owning a stakes in third-tier subsidiaries If a second-tier subsidiary owns a 100% stake in a third-tier subsidiary, the holding company is allowed to own shares in the third-tier subsidiary
Share ownership in non-subsidiaries	Article 8-2 (2)	A holding company's stake in non-subsidiaries should not exceed 5%
Others		Grace period for holding company requirements is two years (can be extended by two years if the FTC approves)

Source: Daewoo Securities Research

Figure 19. Major restrictions on holding companies under the current MRFTA



Source: Daewoo Securities Research

3. Functions and incentives

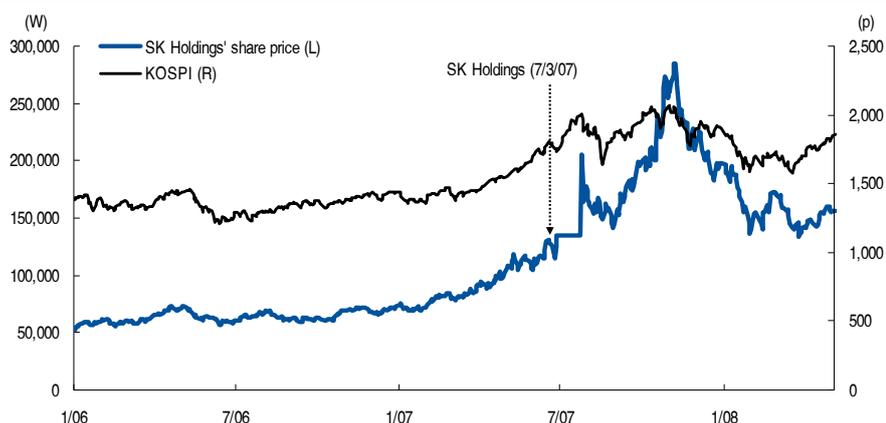
1) Objectives of the holding company structure

A. Efficiency improvement and clear corporate governance

Shares likely to rise in the month before and after the announcement

The holding company structure improves the efficiency of corporate groups by separating the functions of holding companies and subsidiaries. MRFTA stipulates that holding companies are responsible for developing management strategies, while subsidiaries make sure their businesses abide by those strategies. The simple and transparent ownership structure (holding companies own shares in their subsidiaries; and subsidiaries own shares in their second-tier subsidiaries) clarifies the rights and responsibilities of holding companies and subsidiaries. If a company converts to a holding company, its share price usually increases on expectations of corporate governance improvement. When the SK Group announced the adoption of the holding company structure, SK Holdings shares rose 40% in the month before and after the announcement (vs. KOSPI growth of 11%).

Figure 20. Share performance of SK Holdings in the month before and after the announcement



Source: Daewoo Securities Research

Efficient corporate restructuring

B. Efficient corporate restructuring

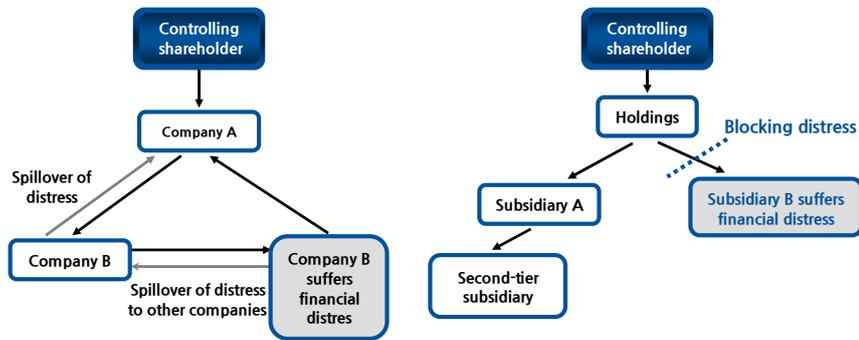
The holding company structure prohibits the cross ownership of shares between subsidiaries and thus, streamlines the processes to acquire and dispose of subsidiaries. During an economic crisis, a holding company can quickly sell insolvent subsidiaries, thereby preventing the insolvency from impacting the entire group.

The failure of a subsidiary in a new business area is unlikely to lead to group-wide financial problems

C. Encouragement of new business investments

Under the holding company structure, the failure of a subsidiary in a new business area is unlikely to lead to group-wide financial problems, since the holding company can simply dispose of the failing subsidiary. The relatively lower risks of entering new businesses should facilitate new investments.

Figure 21. Holding company system prevents insolvency at a subsidiary from impacting the entire group



Source: Daewoo Securities Research

2) Tax incentives to convert to a holding company structure

A. Exclusion of dividends from taxable income

Double taxation can be partially avoided by converting to a holding company structure

A major source of revenue for a holding company is dividends from its subsidiaries. Since subsidiaries pay out dividends based on its after-tax profit, dividends received by a holding company had been subject to double taxation. However, this can now be partially avoided by converting to a holding company structure.

Table 9. Exclusion of dividends from taxable income (%)

Stake		% of excludedsion of dividends from taxable income			
		2006	2007	2008	2009 ~
Holding companies	100%	100	100	100	100
	Listed				
	More than 40% ~ less than 100%	90	90	90	100
	20% or higher ~ less than 40%	60	70	80	80
	Non-listed				
	100%	100	100	100	100
Non-holding companies	100%	100	100	100	100
	Listed				
	More than 30% ~ less than 100%	50	50	50	50
	30% or less	30	30	30	30
	Non-listed				
	100%	100	100	100	100
	More than 30% ~ less than 100%	50	50	50	50
	~ 30%	30	30	30	30

Source: Daewoo Securities Research

B. Deferral of capital gains tax

In order to facilitate the establishment of a holding company, the capital gains tax on stock transactions arising from conversion to a holding company is deferred until the subsidiary involved sells the stock. If a parent company needs to dispose of its stake in a second-tier subsidiary (subsidiary's subsidiary) to meet holding company requirements, it can transfer the stake to a subsidiary. Capital gains on this transaction will be deferred until the subsidiary sells the stake.

C. Exemption on acquisition tax

If an entity acquires a 51% or more stake in a company and becomes a controlling shareholder, the entity is required to pay an acquisition tax according to local tax laws on assets of the acquired company, such as vehicles, machinery equipment, airplanes, vessels, mining/fishing right, real estate, etc. However, in the event that the acquisition is aimed at establishing a holding company or the holding company acquires stakes in its subsidiaries according to MRFTA, the acquisition tax will be exempted. (Restriction of Special Taxation Act, Article 120, Paragraph 6, Subparagraph 8).

4. Structure

While a holding company's assets include investments in operating subsidiaries and affiliates, its operating cash flow is not impacted by such operating subsidiaries and affiliates.

Cash flow from operating subsidiaries: dividends, brand royalties, and rental income

The cash flow received from operating subsidiaries—which include dividends, brand royalties, interest income, and management advisory fees—can be used to cover SG&A and interest expenses and dividend payout. A holding company can also secure funds by selling its stake in its operating subsidiaries and affiliates, or collecting loans made to its subsidiaries. Therefore, the valuation of a holding company rises if it holds multiple operating subsidiaries and a diversified business structure, as it would generate a steady cash flow.

Although equity-method gains are not cash profits, they are considered the most important source of revenue for a holding company, as it is a good indicator of dividend income, which depends on subsidiaries' payout ratios and financials.

Brand royalty income helps to lessen the volatility of a holding company's operating revenue by diversifying its revenue sources, which was previously weighted heavily on dividend income. The downside of dividend income is that it is determined by net profit at subsidiaries, which are determined by sales as well as a variety of non-operating items. On the other hand, brand royalty linked to sales offers a more stable stream of revenues.

Rental income also provides a stable source of cash flow, reducing the holding company's earnings volatility. In addition, operating holding companies, such as Doosan Corporation, generate cash flows from their own businesses.

Table 10. Major income sources of holding companies

Income sources	Details	Cash inflow	
Recurring	Equity-method gains	Equity-method gains from subsidiaries	X
	Dividend income	Dividend income received from subsidiaries	0
	Rental income	Income from renting out a holding company's buildings	0
	Brand royalty	Income from the use of a brand or logo by group affiliates	0
	Holding companies' own businesses	Operating holding companies generate cash flow from their own businesses	0
Non-recurring	Service fee income	Providing advisory services or management information to subsidiaries	0
	Capital gains	Sale of stakes in subsidiaries, IPO, etc.	0

Source: Daewoo Securities Research

5. Mid- to long-term outlook

1) Revisions to the MRFTA

Revisions to MRFTA:
 1) *Non-financial holding companies can own financial subsidiaries*
 2) *Easing of regulations on the stake in a third-tier subsidiary*

A proposal to amend the holding company regulations of the MRFTA was submitted to the National Assembly in October 2007, as the business community demanded the relaxation of regulations, citing the difficulty of converting to a holding company. The revised bill on the MRFTA is still pending at the National Assembly. The details of the revised bill include the permission of non-financial holding companies to hold a financial subsidiary, easing of regulations on the stake in a third-tier subsidiary (from 100% to 20% for listed companies and 40% for non-listed companies), and extension of the grace period for meeting holding company requirements

Table 11. Details of the revisions to the MRFTA

Details	Current	Revised
Separation of the financial and industrial sectors	Non-financial holding companies can not own financial subsidiaries	Non-financial holding companies can own financial subsidiaries
Grace period for holding company requirements	Up to 4 years (2 + 2)	Up to 5 years (2 + 3)
Second-tier subsidiary's ownership of a third-tier subsidiary	Only complete ownership permitted	20% or more for non-listed companies and 40% or more for listed companies

Source: KFTC, Daewoo Securities Research

At present, 55 holding companies remain under the grace period for existing holding company requirements, as they have not met one or more of these requirements, including a debt-to-equity-ratio of less than 200%, ban on non-financial holding companies owning financial subsidiaries, and restrictions on stake holdings in non-affiliated companies and subsidiaries.

If these companies fail to satisfy the requirements within the grace period, they will face fines of up to 10% of the estimated value of each violation (Article 17 of the MRFTA,).

Table 12. Companies under the grace period for existing holding company requirements

Expiration of grace period	Holding companies (# of subsidiaries under the grace period)
2011 (36)	Tbroad Holdings (4), Daesung Holdings (2), CNH (1), Hanjin Holdings (3) Woongjin Holdings (1), Booyoung (1), Woorer Lighting (1), DIP Holdings (1), NOV Korea Holdings (1) Humax Holdings (1), Green Cross Holdings (5), Celltrion Healthcare (4), Daewoong (1), TAS (1) GS (1), SK (1), CJ (1)
2012 (29)	Kolon (9), CS Holdings (1), KC Green Holdings (2), Paradise Global Holdings (4) Mirae Asset Consulting (1), Ocean B Holdings (4), S&T Holdings (1), Hite Holdings (2) Iljin Holdings (1), Prime Development (4)

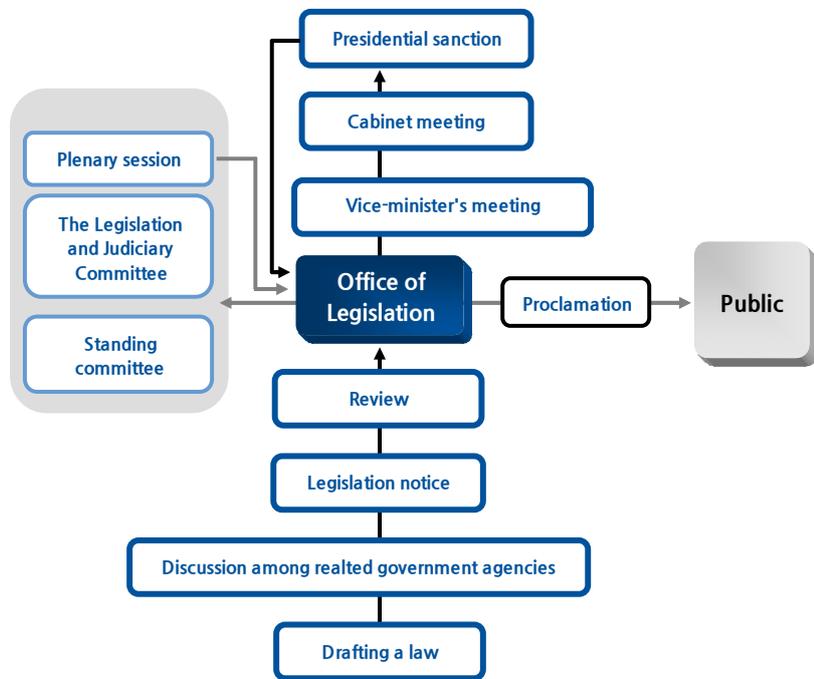
Source: KFTC, Daewoo Securities Research

The revised bill on the fair trade act is still pending

The revised bill on the fair trade act is still pending in the Legislation and Judiciary Committee at the National Assembly. Even if the revised bill is deliberated upon in the Legislation and Judiciary Committee and passed during the upcoming June extraordinary session, there will be controversy over when a revised fair trade act will be implemented.

Under the existing fair trade act, SK Holdings is required to sell SK Securities by July 2, while CJ Holdings must dispose of its stakes in CJ Venture Investment and Samsung Life Insurance by September 3. Doosan Corporation is also required to sell its stake in Doosan Capital and BNG Securities by end-2012.

Figure 22. Legislative proceedings



Source: Office of legislation

2) Outlook for the passage of the revised bill

A. Easing of holding company restrictions to promote business diversification

The revised bill on the fair trade act generates synergies between the financial and industrial sectors

The existing MRFTA prevents non-financial holding companies from owning financial subsidiaries. Large companies, which have not yet converted to holding companies, are allowed to own financial subsidiaries, except credit card, life insurance, non-life insurance, and securities firms. However, if they convert into holding companies, they must sell their stakes in their financial subsidiaries.

These restrictions on non-financial companies owning financial subsidiaries undermine potential synergies from the combination of financial and industrial capital, and discourage business groups with financial subsidiaries from converting to holding companies.

These restrictions also raise a fairness issue compared to the FHCA, which was revised to allow financial holding companies to hold non-financial subsidiaries in December 2009.

Separation of the financial and industrial sectors runs counter to the global trend. In the U.S., holding companies can own all types of financial institutions excluding banks, while in Japan and the eurozone, non-financial holding companies are allowed to own all financial firms, including banks. As such, if the restrictions on the ownership of non-financial companies are eased, it could generate synergies between the financial and industrial sectors.

GE (General Electric) has two major second-tier holding subsidiaries under its holding company structure – 1) GECS, which oversees financial businesses, and 2) NBC Universal, which holds manufacturing subsidiaries. GE Capital utilizes GE's payment guarantee in its bond issuance, while GE Finance offers leasing, financing and other services, contributing to the sales growth of GE's manufacturing subsidiaries.

Table 13. Comparison of non-financial and financial holding companies

Requirements	Non-financial	Financial
Establishment	The holding company is the largest shareholder of its subsidiaries; The combined value of subsidiary shares must exceed 50% of the holding company's assets; The holding company's assets should exceed W100bn; The holding company can only control domestic subsidiaries	Same as the left; Subsidiaries are confined to financial firms; Ownership of foreign subsidiaries is allowed
Entry	Establishment or conversion to a holding company is reported ex post; No regulation on the acquisition of a company as a subsidiary	Establishment/conversion to a holding company or the acquisition of a company as a subsidiary should be approved by the Financial Services Commission beforehand
Business scope	Both the pure and operating holding company structures are allowed	Only the pure holding company structure is allowed; Only the management of subsidiaries is permitted
Holding company requirements	Debt-to-equity ratio of less than 200%; Minimum stakes in subsidiaries (20% for listed companies and 40% for non-listed companies); Up to a 5% stake allowed for non-affiliates; Ban on the ownership of stakes in affiliates other than subsidiaries	Debt-to-equity ratio of less than 200%; Minimum stakes in subsidiaries (30% for listed companies and 50% for non-listed companies); Up to a 5% stake allowed for non-affiliates; Ban on the ownership of stakes in affiliates
Subsidiary requirements	Minimum stake in second-tier subsidiaries (20% for listed companies and 40% for non-listed companies); Subsidiaries not allowed to own stakes in affiliates other than second-tier subsidiaries; Ban on ownership of a financial firm; Second-tier subsidiaries only allowed to hold a wholly-owned third-tier subsidiary	Minimum stake in second-tier subsidiaries (30% for listed companies and 50% for non-listed companies); Ownership of only related companies is allowed; Ownership of non-financial companies allowed
Restrictions on related party transactions	Ban on the ownership of shares of affiliates excluding subsidiaries	Firewalls prevent affiliates from sharing data; Ban on the granting of credit to second-tier subsidiaries by subsidiaries; Ban on transactions of bad assets between a holding company and its subsidiaries or among subsidiaries

Source: Daewoo Securities Research

The revised fair trade bill allows non-financial holding companies and their subsidiaries to own non-banking financial institutions, including insurance and securities firms. If the revised bill becomes law, it should help generate synergies between the industrial and financial sectors.

Table 14. Financial subsidiaries held by non-financial holding companies

Holding companies	Financial companies	% of stake	Expiration of grace period
SK	SK Securities	22.7	7/2/11
CJ	CJ Ventur Capital	90.0	9/03/11
CNH	CHN Lease	100.0	9/29/11
Daesung Holdings	Daesung Venture Capital	50.9	9/30/11
Booyoung	Booyoung Finance	29.5	12/29/11
Iljin Holdings	Itek Investment	70.0	7/3/12
Prime Development	Prime Savings Bank	93.9	9/29/12
	Prime Capital	98.0	
Celltrion Healthcare	Celltrion Venture Capital	100.0	12/31/12
Green Cross Holdings	Green Cross Life Insurance	77.0	12/31/12

Source: FTC, Daewoo Securities Research

The revised fair trade bill requires the establishment of a second-tier holding company

In addition, the revised fair trade bill requires the establishment of a second-tier holding company in the event that a non-financial holding company owns 1) three or more financial subsidiaries including an insurer, or 2) two or more financial subsidiaries whose combined assets exceed ₩20tr. The bill also specifies that a non-financial holding company's minimum stake in its second-tier holding company is 30% for listed companies and 50% for non-listed companies.

Therefore, if the revised bill is passed at the National Assembly, non-financial holding companies will be allowed to own financial subsidiaries by establishing second-tier holding companies, diversifying their business portfolio. We believe that new business opportunities arising from the revised bill will positively affect the valuations of holding companies.

Among large conglomerates, Samsung, Hanwha, Tong Yang, Dongbu, Hyundai-Kia Automotive, and Lotte Groups will be required to establish second-tier holding companies if they seek conversion to holding company structures.

Table 15. Large conglomerates required to establish second-tier holding companies

Group	Ranking	No.	Financial affiliates
Samsung	1	10	Samsung Life Insurance, Samsung Non-life Insurance, Samsung Asset Management Samsung Card, Samsung Securities, Samsung Venture Investment Samsung Futures, Saenbo Real Trust, Samsung Claim Adjustment Service Anycar Service
Hyundai Motor	4	4	HMC Securities, Hyundai Card, Hyundai Capital, Hyundai Commercial
Lotte	7	10	Lotte Non-life Insurance, Lotte Card, Lotte Capital, My Bi, Hanpaysys, Busan Hanaro Card, EB Card
Hanwha	16	10	SNR Bank, Korea Life Insurance Investigation, Korea Life Insurance, Korea TMS Hanwha Venture Capital, Hanwha Non-Life Insurance, Hanwha Securities Hanwha Investment Trust Management, Prudential Securities, Prudential Asset Management
Dongbu	25	7	Dongbu Savings bank, Dongbu Life Insurance, Dongbu Non-life Insurance Dongbu Asset Management, Dongbu Securities, Dongbu Capital, Dongbu Claim Adjustment service
Tong Yang	46	7	Tong Yang Life Insurance, Tong Yang Securities, Tong Yang Investment, Tong Yang Capital, Tong Yang Asset Management, Tong Yang Financial

Note: As of February 1, 2011

Source: FTC, Daewoo Securities Research

Easing third-tier subsidiary requirements to promote new investments

B. Easing third-tier subsidiary requirements to promote new investments

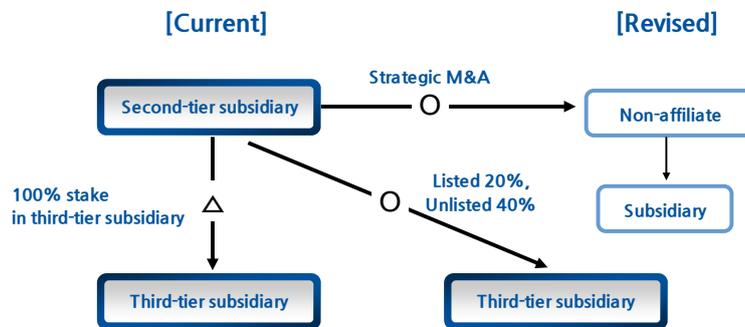
The MRFTA prohibits the existence of third-tier subsidiaries within a holding company structure, except when the second-tier subsidiaries own 100% of the third-tier subsidiaries.

Since this requirement (100% ownership) poses a financial burden on second-tier subsidiaries, holding companies have found it difficult to expand into new businesses and improve competitiveness through strategic alliances (at second-tier subsidiary levels). Subsidiaries have also had difficulty pursuing corporate restructuring through M&As because they are required to purchase 100% stakes of the subsidiaries of acquisition targets (if the acquired companies are second-tier subsidiaries).

However, these issues are likely to be mitigated, as the amended MRFTA should loosen the requirement regarding the holding of third-tier subsidiaries.

Even if second-tier subsidiaries are permitted to have their own subsidiaries, the original purpose of the introduction of holding companies should remain unaffected. The introduction of holding companies was meant to improve the transparency of corporate governance through a simple vertical shareholding structure (holding companies ⇒ subsidiaries ⇒ second-tier subsidiaries ⇒ third-tier subsidiaries). Even if second-tier subsidiaries are allowed to govern their subsidiaries, the vertical shareholding structure will remain intact.

Figure 23. Easing of third-tier subsidiary ownership requirements



Source: Daewoo Securities Research

C. Grace period to be extended

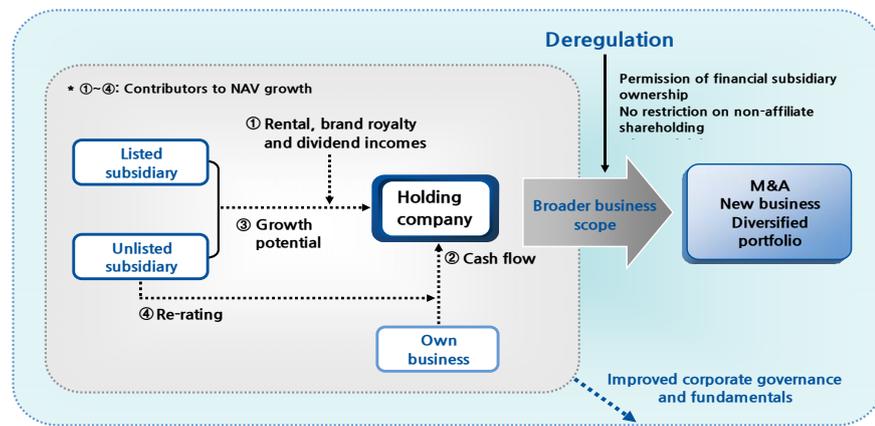
Extended grace period to relieve burdens

At present, the short grace period to satisfy holding company requirements (for companies converting into a holding company) has been a burden.

It takes an enormous amount of expenses and time to fundamentally change the ownership structure of a corporate group by moving enough shares to meet the relevant requirements. The current grace period of two years is not sufficient for the enactment of such fundamental change, in our opinion.

Furthermore, if a holding company seeks to sell financial subsidiaries in the two years following its conversion (into a holding company), it cannot exert strong bargaining power given that such a sale would be widely expected (as the law mandates it).

Figure 24. New business opportunities for holding companies following regulatory changes



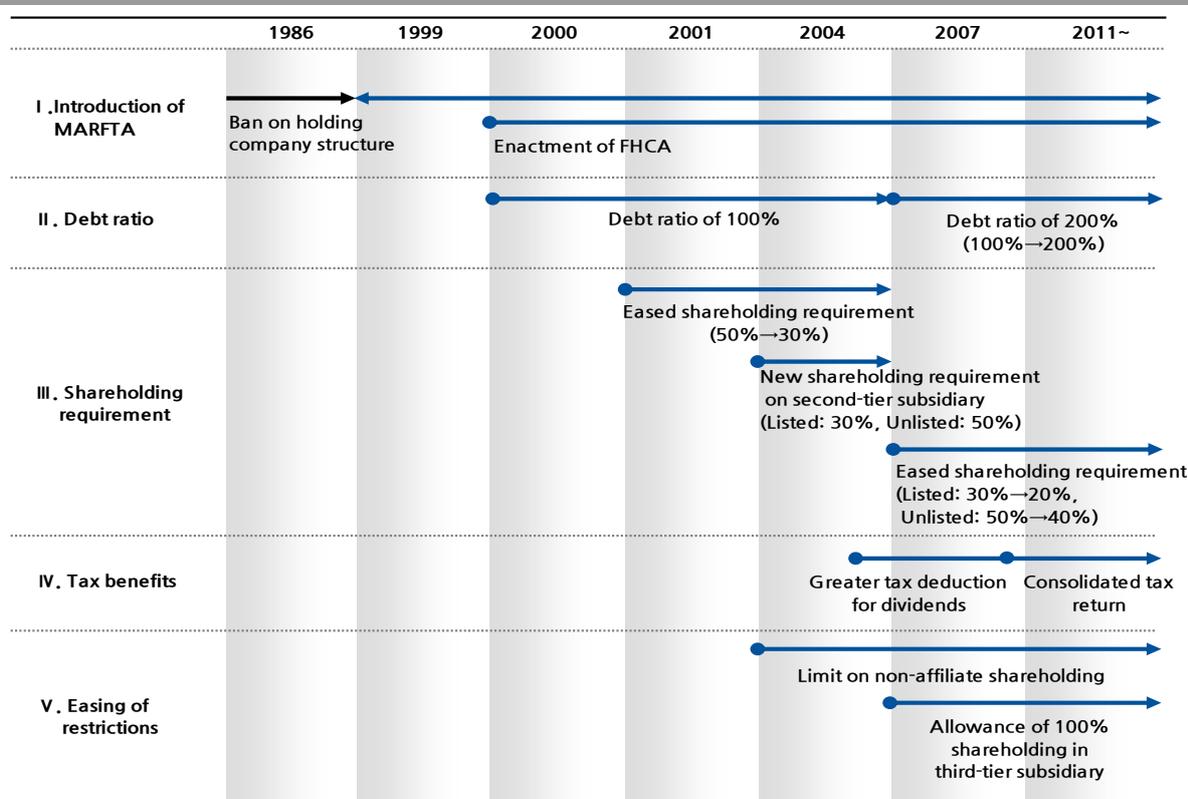
Source: Daewoo Securities Research

6. Policy implications

The government is anticipated to provide further support

A growing number of Korean companies are converting into holding companies in order to: 1) secure stable ownership stakes and facilitate corporate restructuring, 2) boost shareholder value by improving corporate governance, and 3) improve their corporate reputations. The pace of this trend is likely to pick up speed, as the government is anticipated to provide further support for the aforementioned conversion (after the National Assembly passes the amended MRFTA). Indeed, the government has improved policies to promote corporate groups' conversion into holding companies and is likely to further expand incentives (e.g., tax benefits) for companies that make the conversion going forward.

Figure 25. Revisions to the MRFTA



Source: Daewoo Securities Research

Analyzing related policies in other nations should prove helpful to our efforts to predict future domestic policies. Currently, only Korea and Japan have laws that define and regulate holding companies. As mentioned earlier, in Japan, holding companies just need to notify the relevant authorities if they intend to purchase more than 10% of a non-affiliated company's shares. In other words, Korea is the only nation that places restrictions regarding holding companies' debt-to-equity ratios and non-affiliate shareholding.

Major advanced nations—including the U.S., Germany, France, and Great Britain—do not legally define holding companies and thus have no restrictions on the establishment and management of holding companies. These nations place restrictions on holding companies' acquisition of non-affiliate shares only when an acquisition would stifle competition.

Table 16. Holding company policies in other countries

Regulations	U.S.	Europe	Japan
Definition	None	None	A company whose combined value of subsidiary shares must exceed 50% of its assets
Total assets	None	None	More than JPY600bn (reporting requirement)
Debt-to-equity ratio	None (Bank holding company: 50%)	None	None
Joint investment	None	None	Only joint investments between subsidiaries are allowed
Subsidiary shareholding	None	None	None
Segregation of financial and industrial sectors	Ban on a non-financial holding company's ownership of banks	None	A financial holding company is banned from owing both a large financial subsidiary with assets of more than JPY15tr and a business subsidiary with assets of more than JPY300bn
Non-affiliate shareholding	None	None	A holding company is required to report to relevant authorities if it purchases non-affiliate stakes exceeding 10% of the non-affiliated company's outstanding shares
Third-tier subsidiary	None	None	None

Source: Daewoo Securities Research

In the domestic stock market, holding companies' shares are trading at a discount. The values of holding companies are considered to be even lower than the combined values of their subsidiaries. In other words, holding companies' shares are undervalued relative to their net asset values.

We attribute this discount to the following:

Shares are undervalued:
 1) *Preference for direct investments*
 2) *Holding companies have low cash flows*

First, investors prefer direct investments in blue-chip subsidiaries over investments in holding companies.

Second, holding companies have low cash flows. For investors who are not interested in corporate control, holding companies' shares are not attractive, given that dividend income from subsidiaries is their major revenue source.

Third, investments in holding companies could be a big risk, as corporate groups' expansion into new businesses is normally led by holding companies (parent companies).

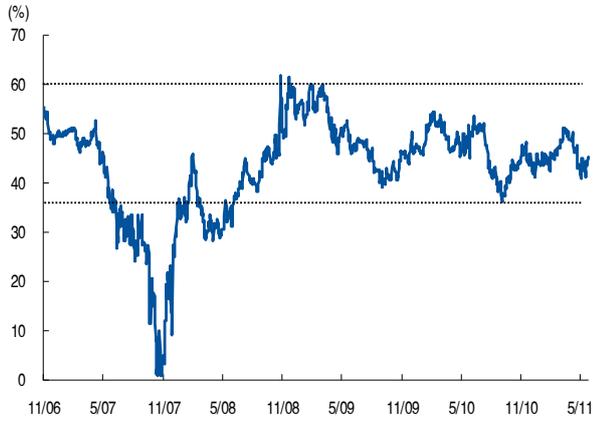
In light of holding companies' strong governance and close relations between affiliates, we remain skeptical that a discount to holding companies can be justified. However, shares of holding companies' have historically traded at a discount. As such, we believe that historical share prices can provide a good base for valuations.

Growth stories depend on the performances of major subsidiaries

After looking at historical data, we believe that the current discount levels are too heavy. And we expect discounts to gradually decrease, as the Korean government is anticipated to accelerate deregulations starting with the revision to the MRFTA.

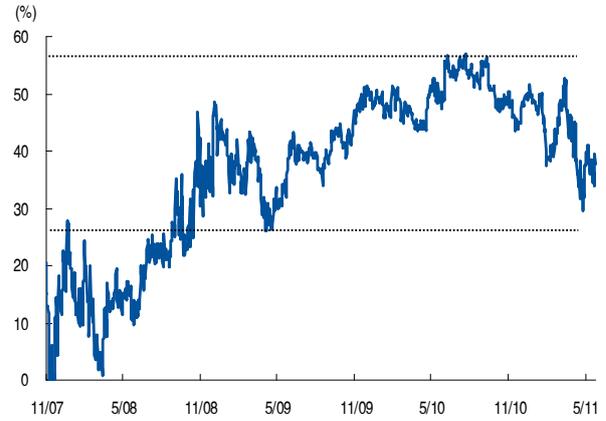
As we mentioned earlier in this report, a holding company does not fall under a particular industry. As such, shares of holding companies' do not move in concert. Rather, their shares are likely to show different growth stories depending on the performances of their major subsidiaries.

Figure 26. LG Corp.'s NAV discount trend



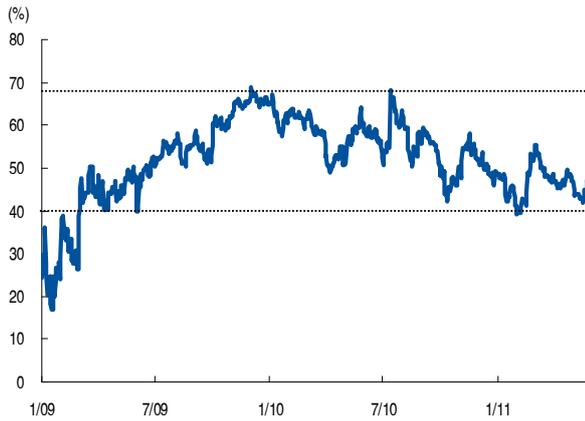
Source: Daewoo Securities Research

Figure 27. SK Holdings' NAV discount trend



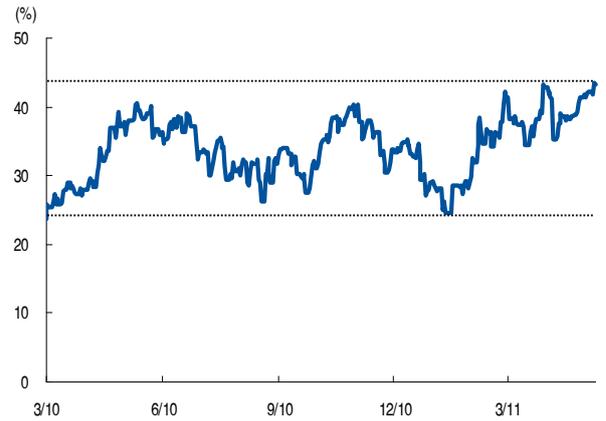
Source: Daewoo Securities Research

Figure 28. Doosan Corp.'s NAV discount trend



Source: Daewoo Securities Research

Figure 29. Hanwha Corp.'s NAV discount trend



Source: Daewoo Securities Research

LG Corp. (003550 KS)

Buy (Initiate)

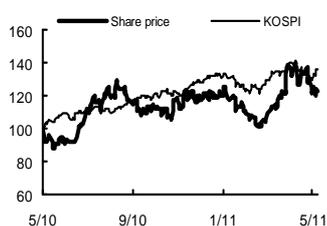
Target Price (12M, W)	130,000
Share Price (06/01/11, W)	89,000
Expected Return (%)	46.1
EPS Growth (11F, %)	1.4
Market EPS Growth (11F, %)	27.3
P/E (11F, x)	36.7
Market P/E (11F, x)	10.9
KOSPI(11F/06/01,p)	2,141.34
Market Cap (Wbn)	15,358
Shares Outstanding (mn)	176
Avg Trading Volume (60D, '000)	970
Avg Trading Value (60D, Wbn)	87
Dividend Yield (11F, %)	1.1
Free Float (%)	51.4
52-Week Low	63,100
52-Week High	101,000
Beta (12M, Daily Rate of Return)	1.2
Price Return Volatility (12M Daily, %SD)	2.1
Foreign Ownership (%)	27.4

Major Shareholder(s):

Koo Bon Moo et al. (48.59%)

Price Performance

(%)	1M	6M	12M
Absolute	-9.6	8.4	33.0
Relative	-7.3	-2.6	1.7



Valuable subsidiaries and strong cash flow

- Solid profitability at subsidiaries contribute to LG Corp.'s NAV growth
- Listing of LG Siltron to increase NAV
- Initiate coverage with a Buy rating and a TP of W130,000

We initiate our coverage of LG Corp. with a Buy rating and a target price of W130,000. We calculated LG Corp.'s NAV using sum-of-the-parts valuation methodology by subtracting net borrowings from the sum of the value of the company's investment securities in its listed and unlisted subsidiaries, and the present value of the company's future brand royalties and rental income.

Our investment recommendation is based on the following:

1) Bright outlook for chemicals and electronics subsidiaries

LG Corp.'s NAV will likely increase beginning in 1Q11, as 1) LG Electronics is anticipated to turn around, and 2) the company's chemicals (LG Chem and LG Household and Health Care) and telecom subsidiaries (LG U+) should report solid profitability.

2) Listing of LG Siltron

LG Siltron (51% owned by LG Corp.) is the only 12-inch wafer producer in Korea. The listing of the company (expected in August~October) should further drive LG Corp.'s NAV if its earnings improve and the industry outlook brightens.

3) Strong cash inflows to finance new businesses

We expect LG Corp.'s cash flows to continue to expand, thanks to dividend income (from subsidiaries), brand royalties, and rental income (real estate holdings). These robust cash flows should enable LG Corp. to invest in new businesses and real estate (to secure additional rental income).

In 2011, we expect LG Corp. to deliver solid operating results driven by improvements in subsidiaries' earnings, with operating revenue and operating profit of W627.8bn (up 8.9%) and W508.2bn (up 6.5%), respectively.

► Earnings & Valuation Metrics

FY	Sales (Wbn)	OP (Wbn)	OP Margin (%)	NP (Wbn)	EPS (W)	EBITDA (Wbn)	FCF (Wbn)	ROE (%)	P/E (x)	P/B (x)	EV/EBITDA (x)
12/09	1,767	1,588	89.9	1,538	8,747	1,615	195	22.6	8.3	1.7	7.9
12/10	591	475	80.4	421	2,394	484	402	5.9	36.5	2.2	31.2
12/11F	605	489	80.9	427	2,427	490	395	6.0	36.7	2.2	31.6
12/12F	684	550	80.4	480	2,728	550	487	6.5	32.6	2.1	28.1
12/13F	724	583	80.5	509	2,894	583	513	6.6	30.7	2.0	26.5

Source: Company data, Daewoo Securities Research estimates

1. Valuation

Present Buy rating with
TP of W130,000

We initiate our coverage of LG Corp. with a Buy rating and a target price of W130,000, and present the company as our top pick among holding companies. We derived our target price using sum-of-the-parts valuation methodology by subtracting net borrowings from the sum of the value of the company's investment securities in its listed and unlisted subsidiaries, and the present value of the company's future brand royalties and rental income. Since LG Corp. is a pure holding company, investment securities are the company's operating asset.

LG Corp. currently has fifteen subsidiaries (seven listed and eight unlisted). For our valuation, we used the market caps of listed subsidiaries, and the book values of unlisted subsidiaries. For LG CNS, LG Serveone and LG Siltron, however, we calculated their fair values as shown in <Table 20>, taking into account the size of their earnings and the scheduled stock listings.

Table 17. Calculation of target price for LG Corp. (Wbn)

	Value	Remarks
1. Present value of future income	3,906	
Operating value	-	A pure holding company
Brand royalty	2,735	Terminal growth rate=2%, WACC=11%
Real estate	1,171	Fair value
2. Investment asset value	26,408	
Listed subsidiaries	20,599	Based on market value
Unlisted subsidiaries	5,810	Based on book value
3. Total asset value (1+2)	30,314	
4. Net borrowing	-76	End-4Q 2010
5. NAV (3-4)	30,390	
6. No. of shares ('000)	175,756	Outstanding shares
7. NAV per share (W)	172,910	
8. Target price (W)	130,000	Applied discount rate of 20%
Current price (W)	89,000	As of June 1, 2011
Discount rate (%)	48.5	
Upside potential (%)	46.1	

Source: Daewoo Securities Research

Table 18. Estimated value of investment securities (Wbn)

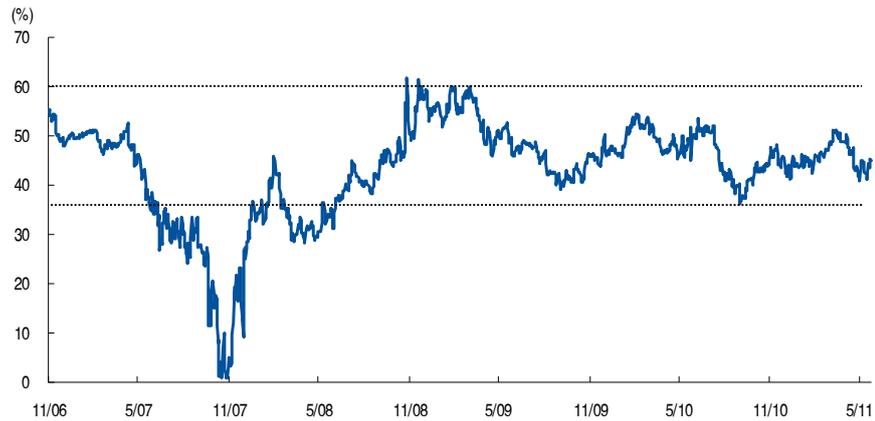
	% of stake	Book value	Current price	Value	Remarks
Listed subsidiaries				20,599	
LG Electronics	34.8%	2,559	98,500	4,958	
LG Chem	33.5%	1,278	531,000	11,799	
LG U+	30.6%	1,162	5,770	908	
LG Housys	33.5%	184	72,400	218	
LG H&H	34.0%	142	455,000	2,418	
LG Life Science	30.4%	83	47,300	239	
GIIR	35.0%	39	10,100	59	
Unlisted subsidiaries				5,810	
LG CNS	85.0%	331		1,760	
Serveone	100.0%	223		2,579	
LG Siltron	51.0%	240		1,341	
LG MMA	50.0%	115		58	
LG Solar Energy	100.0%	27		27	
Lusem	64.8%	29		19	
LG MDI	100.0%	17		17	
LG Hitachi	49.0%	14		7	
LG Sports	100.0%	1		1	

Source: Daewoo Securities Research

LG Corp. licenses its brand to subsidiaries in return for royalties. Brand royalty income equals 0.2% of the previous year's consolidated subsidiary sales, minus advertising expenses. Under such a business structure, royalty income rises as subsidiaries' sales increase.

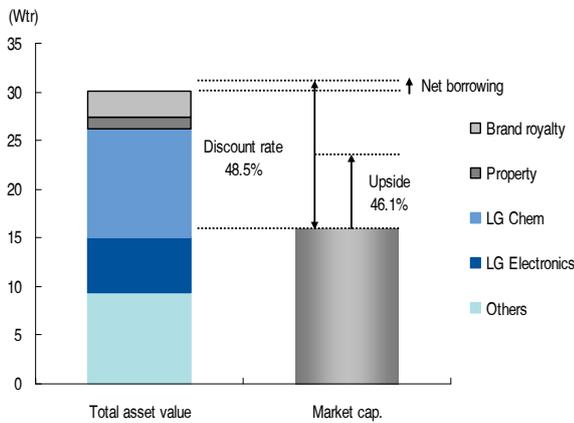
The value of LG Corp.'s real estate holdings is determined by the fair values of LG Twin Towers, LG Gasan Digital Center, and an office building in Gwanghwamun.

Figure 30. Trend of LG Corp.'s discount rate



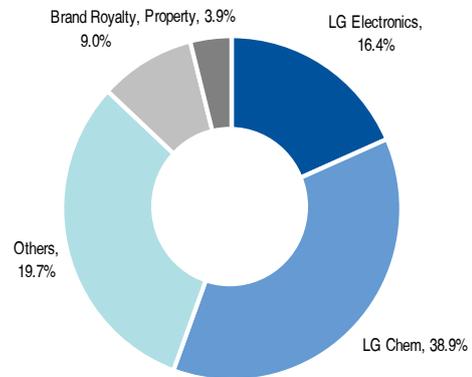
Source: Daewoo Securities Research

Figure 31. LG Corp.'s NAV breakdown



Source: Daewoo Securities Research

Figure 32. Contribution to LG Corp.'s NAV



Source: Daewoo Securities Research

2. Company overview

1) Overview

LG established the first holding company in Korea

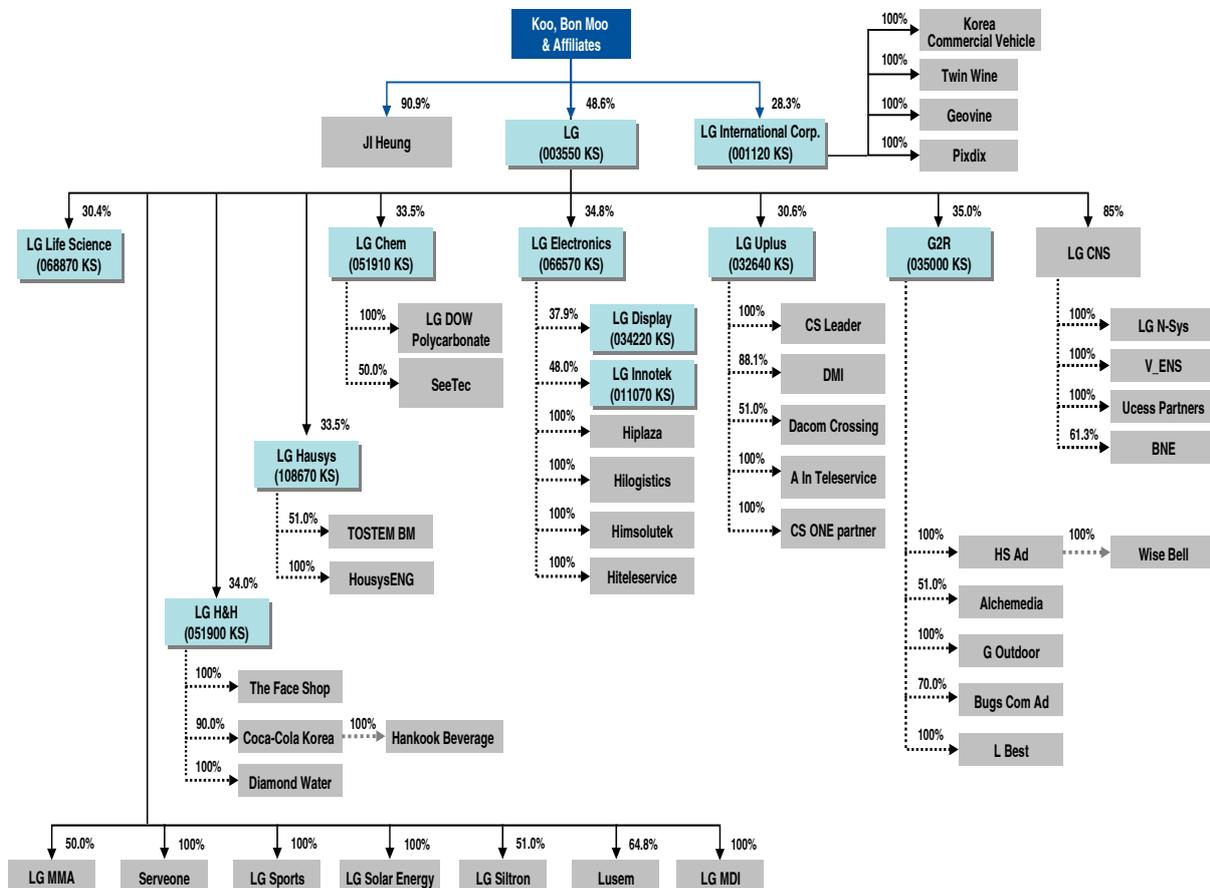
LG Corp. (003550 KS) is the holding company of LG Group, the first of its kind in Korea. LG Group, which has 59 affiliates with total assets of W90.6tr and sales of W107.1tr, is the sixth largest conglomerate in Korea, following Samsung, Hyundai-Kia Automotive Group and SK Group, to name a few.

In 2003, LG Corp. was established as the holding company of LG Group, following the: 1) merger between LG CI (the holding company of LG's chemical subsidiaries) and LG EI (the holding company of LG's electronics subsidiaries); and 2) the acquisition of LG MRO, including its real estate leasing business and other investment interests.

The newly established holding company 1) spun-off three subsidiaries, including GS Calex, GS Home Shopping and GS Retail, and part of its leasing business (as of July 1, 2004); and 2) reorganized its subsidiaries into three segments (electronics, chemicals and telecom).

Since LG Corp. is roughly 49% owned by related parties (as of March 2011), the company has a stable ownership structure and management control. LG Corp. directly and indirectly controls its subsidiaries. The holding company owns equity stakes in major subsidiaries (such as LG Electronics), and the major subsidiaries hold stakes in second-tier subsidiaries in their respective business segments.

Figure 33. LG Corp.'s corporate governance



Source: DART, Daewoo Securities Research

2) Analysis of affiliates and corporate governance

LG Group's businesses are largely divided into four segments: 1) electronics/SI (LG Electronics and LG Display), 2) chemicals (LG Chem), 3) telecom (LG U+, which was incorporated following the merger between LG Dacom and LG Powercom), and 4) distribution/advertising (LG International, SeeTec, LG Serveone) and other services.

Electronics/SI segment accounts for over 60% of the group's top line

LG Group has grown more reliant on the electronics and chemicals businesses after reorganization, with the electronics/SI segment accounting for over 60% of the group's top line, EBITDA, fixed asset investments and borrowings.

As of end-2009, electronics/SI accounted for 63% of the group's total sales, while chemicals and telecom/others contributed 19% (the same level as in 2008) and 9%, respectively. By company, LG Electronics made the greatest contribution to sales, followed by LG Display, LG Chem, LG U+, and LG International (their combined sales represent 80% of the group's total sales). In terms of operating profit, the contribution of the chemicals segment jumped to 38% (from 27%), while that of the electronics/SI segment fell to 46% (from 56%).

Table 19. Major subsidiaries by business type

Type of business	Listed	Unlisted
Holding company (1)	LG Corp. (003550 KS)	-
Electronics (9)	LG Electronics (003550 KS) LG Display (0034220 KS) LG Innotek (011070 KS)	LG Siltron, Lusem, Hiteleservice, Hiplaza Hi Business Logistics, Himsolutek
Chemicals (14)	LG Chem (051910 KS) LG Life Science (068870 KS) LG H&H (051900 KS) LG Housys (108670 KS) LG Uplus (032640 KS)	LG MMA, LG Polycarbonate, SeeTec, Coca-Cola Korea Hankook Beverage, Diamond Water, The Face Shop TOSTEM BM, HousysENG
Telecom/other services (27)	LG International (001120 KS) GIIR (035000 KS)	LG MMA, A-in Teleservice, DMI, Dacom Crossing

Source: Daewoo Securities Research

3) Business analysis

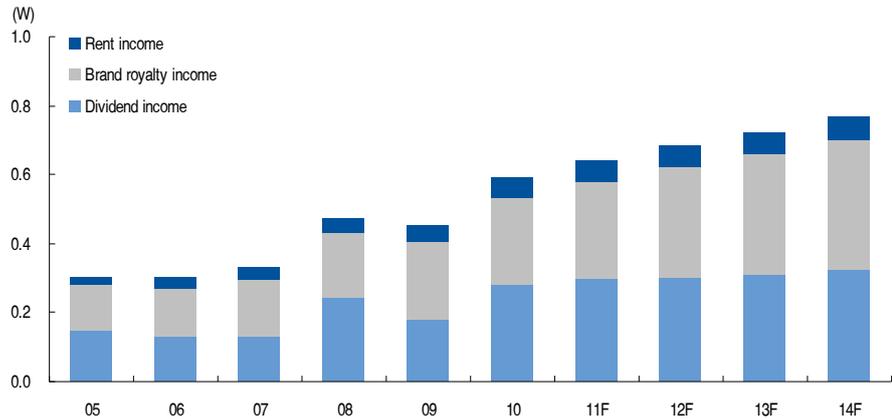
LG Corp. is a pure holding company which does not operate its own businesses. The company’s revenue stems mainly from brand royalties, rental income and dividend income; its costs are primarily limited to general administrative expenses (labor costs) and advertising fees (brand marketing).

Currently, LG Twin Towers is LG Corp.’s largest source of rental income. However, rental income should expand starting in 2011, thanks to the recently-completed LG Gasan Digital Center and an office building in Gwanghwamun.

Brand royalties serve as stable source of income

Since January 2005, LG Corp. has collected brand royalties from LG Group affiliates including LG Electronics (roughly 50% of total brand royalties) and LG Chem. In 2010, LG Corp.’s brand royalty income surged 16.5% to W223.8bn thanks to sales expansion at major group affiliates, and the number is expected to increase 12.1% to W252.8bn in 2011.

Figure 34. Annual core income trend and outlook

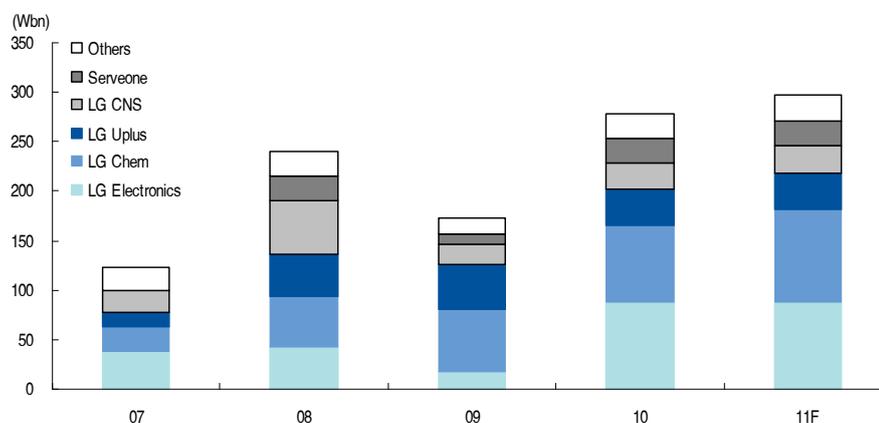


Source: Daewoo Securities Research

In the mid-term, LG Corp. should continue to report solid operating profits, as: 1) the company's diversified business portfolio (electronics, chemicals and telecom) can act as a buffer against economic downturns, and 2) rising brand royalties and rental income should stabilize earnings. Since 2008, brand royalties and dividend income have increased, as: 1) LG Group's overall business performance has improved thanks to sales and profitability growth at affiliates, and 2) the group has made a concerted effort to improve global brand awareness.

In view of LG Group's solid business outlook, stable brand royalties, and the prospect of additional rental income following the completion of an office building, we forecast LG Corp.'s 2011 operating profit at roughly W450bn, excluding operating expenses.

Figure 35. Dividend income by subsidiary



Source: Daewoo Securities Research

Table 21. Equity method income by major subsidiary

(Wbn, %)

Subsidiaries	% of stake	Equity method income				%			
		2007	2008	2009	2010	2007	2008	2009	2010
LG Electronics	34.8%	218.9	127.9	640.4	382.0	25.5	16.8	42.9	31.1
LG Chem	33.5%	165.8	290.3	447.8	645.2	19.3	38.2	30.0	52.5
LG Uplus	30.6%	166.3	147.1	168.0	56.2	19.4	19.3	11.3	4.6
LG Housys	33.5%	0.0	0.0	6.1	11.8	0.0	0.0	0.4	1.0
LG H&H	34.0%	13.8	34.3	48.6	69.6	1.6	4.5	3.3	5.7
LG Life Science	30.4%	-13.1	-14.1	8.2	3.7	-1.5	-1.9	0.5	0.3
LG MMA	50.0%	16.8	14.8	27.2	49.0	2.0	1.9	1.8	4.0
LG CNS	85.0%	86.7	75.4	78.6	0.0	10.1	9.9	5.3	0.0
Servone	100.0%	47.7	57.8	56.2	0.0	5.6	7.6	3.8	0.0
LG Siltron	51.0%	79.0	-2.4	-33.7	0.0	9.2	-0.3	-2.3	0.0
Others	-	75.5	29.2	45.1	11.4	8.8	3.8	3.0	0.9

Source: Daewoo Securities Research

3. Subsidiary business trend and outlook

In 2011, we expect LG Corp.'s subsidiaries to report operating results similar to those in the previous year. The chemicals segment is anticipated to deliver the strongest performance. The electronics/SI segment has experienced high earnings volatility in the wake of the global financial crisis, but telecom and other services should continue to report stable earnings.

1) Electronics

Electronics/SI segment on track to recovery

In 2010, the electronics/SI segment suffered from high earnings volatility. However, LG Corp.'s bout of volatility was less severe and shorter than that experienced by rival companies. Moreover, earnings recovered quickly as the market picked up. We believe that LG Corp.'s electronics/SI subsidiaries could reduce volatility inherent to the IT industry by 1) improving product competitiveness and 2) increasing market shares in the handset, display (TFT-LCD) and flat panel TV industries.

LG Corp.'s electronics/SI subsidiaries have generated stable operating revenues, secured top-line growth, and increased their contributions to the holding company's EBITDA growth over the past three years. The representative subsidiaries of this segment include LG Electronics and LG Display.

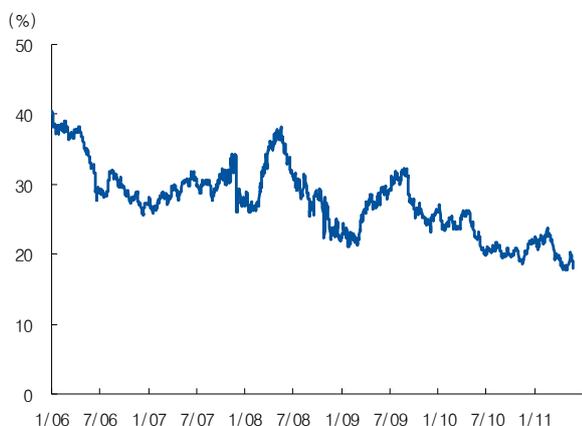
Table 20. Quarterly earnings forecast for LG Electronics

(Wbn)

	2010					2011F				
	1Q	2Q	3Q	4Q	Annual	1QP	2QF	3QF	4QF	Annual
Sales	13,217.3	14,409.7	13,429.1	14,697.7	55,753.8	13,159.9	15,178.8	15,576.8	16,934.5	60,850.1
Operating profit	481.1	158.9	-185.2	-245.7	209.1	130.8	338.1	323.5	414.5	1,206.9
OP Margin (%)	3.6	1.1	-1.4	-1.7	0.4	1.0	2.2	2.1	2.4	2.0
Pretax profit	758.8	62.2	-16.7	-373.8	430.5	38.5	449.5	404.6	477.3	1,369.9
Net profit	674.6	856.4	7.6	-256.4	1,282.2	-15.8	359.6	323.7	381.8	1,049.3
Handset sales	27,098	30,562	28,401	30,554	116,615	24,452	26,309	31,789	34,734	117,284
TV sales	9,131	9,304	9,386	11,605	39,426	9,418	11,156	11,088	13,696	45,357
(LCD TV)	5,168	5,145	5,448	7,491	23,252	5,783	6,914	7,079	9,553	29,329

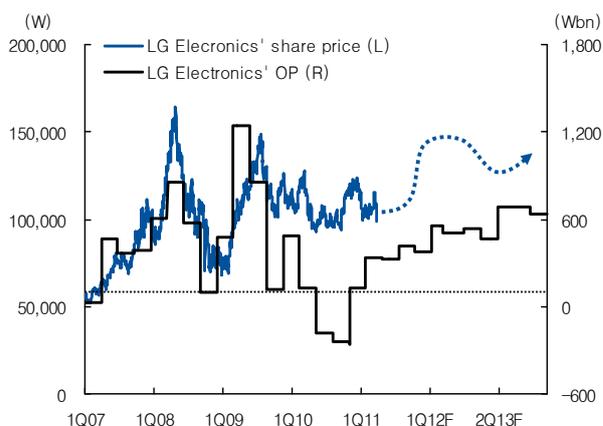
Source: Daewoo Securities Research

Figure 36. Contribution of LG Electronics to LG Corp.'s NAV



Source: Daewoo Securities Research

Figure 37. LG Electronics' share price and operating profit trends



Source: Daewoo Securities Research

2) Chemicals

Efficiency improved thanks to vertical integration

LG Corp.'s chemicals segment boasts vertically integrated manufacturing and a diversified product portfolio, producing everything from feedstock to intermediate materials and synthetic resins. The chemicals subsidiaries are broadening their business scope from petrochemicals to advanced materials. Indeed, significant progress has been made recently on their information and communication material projects (rechargeable battery and polarizer) conducted in partnership with LG Electronics and LG Display. We believe that such diversification has protected these subsidiaries from market volatility, and has enabled them to report solid earnings for the past couple of years.

We expect LG Chem's operating profit to show a CAGR of 14% until 2015. In 2015, the petrochemical division's contribution to the company's operating profit should fall to 50%, as that of high value-added products (including information materials, mid- to large-sized cells and glass substrates) rises. In particular, materials used in rechargeable batteries, solar cells and OLED appear to possess huge growth potential in 2015 and beyond.

We project that LG Chem's petrochemical division—which led the company's significant earnings growth in 1Q—will continue to report strong earnings until 3Q11. Prices of LG Chem's flagship products (phenol, etc.) should remain robust for the time being, as the company's main Japanese rivals have not normalized production due to power shortages.

Table 21. Quarterly earnings forecast for LG Chem

(Wbn)

	2010					2011F				
	1Q	2Q	3Q	4Q	Annual	1Q	2Q	3Q	4Q	Annual
Sales	4,423.1	5,028.1	5,021.3	4,998.9	19,471.4	5,490.9	5,965.1	6,095.3	4,615.3	22,166.5
Chemicals	3,308.6	3,765.1	3,768.0	3,809.1	14,650.8	4,292.8	4,672.5	4,763.7	3,404.9	17,133.9
I&E materials	1,152.6	1,285.3	1,270.5	1,200.1	4,908.5	1,193.0	1,305.9	1,285.7	1,125.8	4,910.3
Operating profit	652.4	827.9	778.8	562.2	2,821.3	835.3	937.3	951.5	724.4	3,448.5
Chemicals	490.1	623.9	620.8	544.0	2,278.8	735.6	784.3	753.2	529.7	2,802.8
I&E materials	175.0	210.5	170.7	43.9	600.1	112.7	153.0	178.3	164.1	608.1
OP Margin	14.8	16.5	15.5	11.2	14.5	15.2	15.7	15.6	15.7	15.6
Chemicals	14.8	16.6	16.5	14.3	15.6	17.1	16.8	15.8	15.6	16.4
I&E materials	15.2	16.4	13.4	3.7	12.2	9.4	11.7	13.9	14.6	12.4
Pretax profit	648.8	821.6	790.6	566.6	2,827.6	648.8	821.6	790.6	566.6	2,827.6
Net profit	517.7	645.7	599.1	444.2	2,206.7	517.7	645.7	599.1	444.2	2,206.7

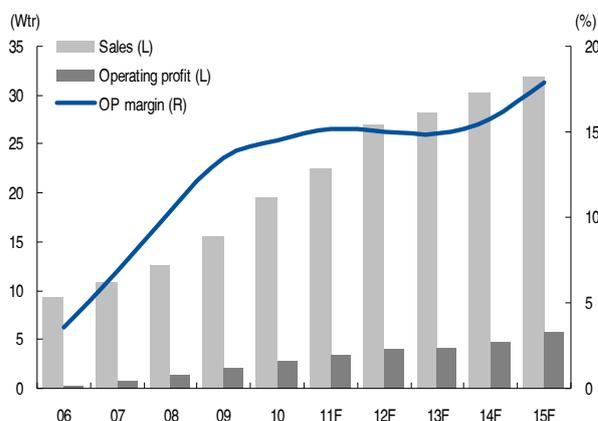
Source: Daewoo Securities Research

Figure 38. Contribution of LG Chem to LG Corp.'s NAV



Source: Daewoo Securities Research

Figure 39. LG Chem's share price and operating profit trends



Source: Daewoo Securities Research

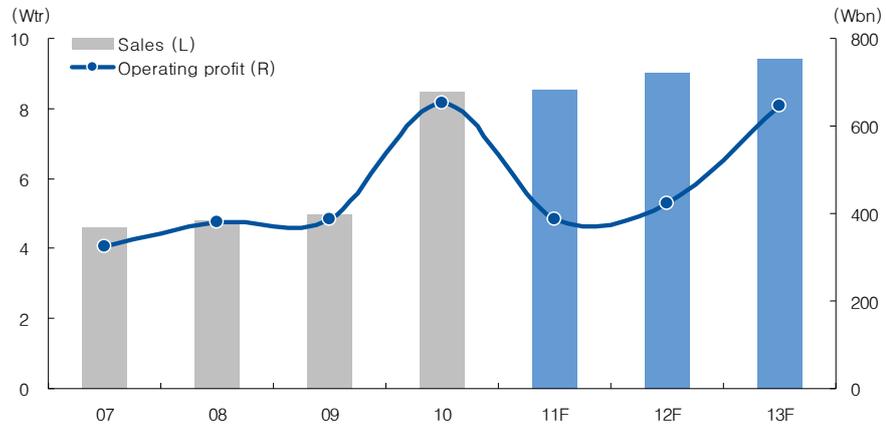
3) Telecom/other services

Telecom and other services have reported solid earnings

LG Corp.'s telecom subsidiaries were latecomers to the market; they have yet to catch up with SK Telecom and KT. However, they report stable earnings every year, as the barriers to market entry are high. Moreover, they successfully responded to market and policy changes related to VoIP and wired/wireless service integration.

On January 1, 2010, LG Group's wired and wireless businesses were integrated following the merger between LG Telecom, LG Dacom and LG Powercom. The merger appears to have been motivated by the increasing convergence of the market, necessitating efficient and integrated business strategies. Through the merger, the telecom segment should be able to strengthen its mid- to long-term competitiveness (in addition to economies of scale).

Figure 40. LG Uplus' sales and operating profit trends and outlook



Source: Daewoo Securities Research

4. Investment points

1) Electronics to pick up momentum; Chemicals to continue to report strong earnings

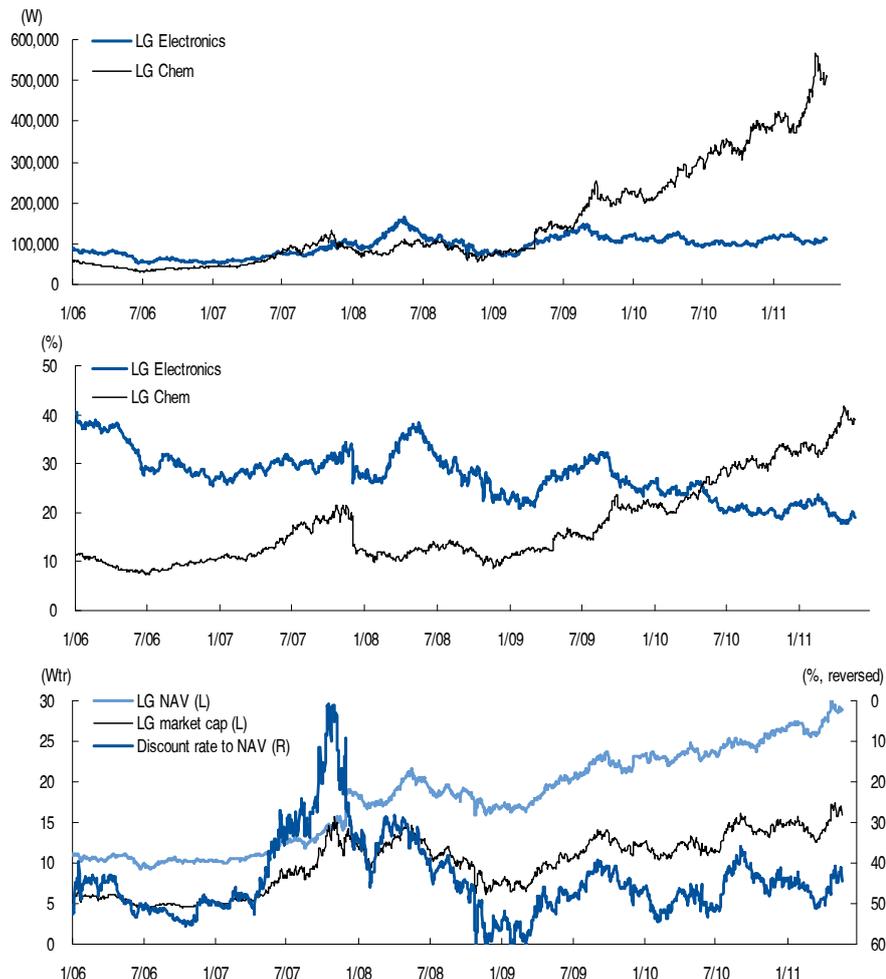
LG Electronics swung to positive territory in 1Q; LG Chem to continue to report solid earnings until 3Q

LG Corp.'s NAV will likely increase beginning in 1Q11, as 1) LG Electronics is anticipated to turn around, and 2) the chemicals (LG Chem and LG Household and Health Care) and telecom subsidiaries (LG U+) should report solid profitability.

LG Electronics' home appliance and air conditioner businesses suffered deteriorating profitability due to higher raw material prices. However, profitability should improve steadily thanks to new product launches and cost-cutting efforts. LG Electronics' operating profit came in at W130.8bn in 1Q11, swinging to positive territory after three consecutive quarters of losses. We are also upbeat on the company's earnings in 2Q and beyond, as the handset and TV units will likely deliver better earnings going forward, and air conditioner sales should pick up full swing towards summer.

We will likely raise our earnings projections for LG Chem, in light of the company's projected entry into the polysilicon market, and the possible expansion of 3D retarder sales. In particular, the company's petrochemical division should continue to report robust earnings until 3Q thanks to capacity expansion and tight supply.

Figure 41. Share performances of LG Electronics and LG Chem, and LG Corp.'s NAV trend



Source: Daewoo Securities Research

2) Listing of LG Siltron

LG Siltron to contribute to LG Corp.'s NAV growth after listing

LG Siltron, 51% owned by LG Corp., is the only 12-inch wafer maker in Korea. As of 2010, LG Siltron ranked fourth in the global wafer market, with global and domestic market shares of roughly 9% and 33%, respectively. The company's main customers include Samsung Electronics and Hynix, which respectively accounted for 31% and 15% of its total sales in 2010. LG Siltron should benefit from the strong performance of Korean semiconductors, especially in the DRAM market.

Since 2001, LG Siltron has secured a competitive edge over its rivals by investing in 12-inch wafers. In 2010, this product accounted for 63.3% of total sales.

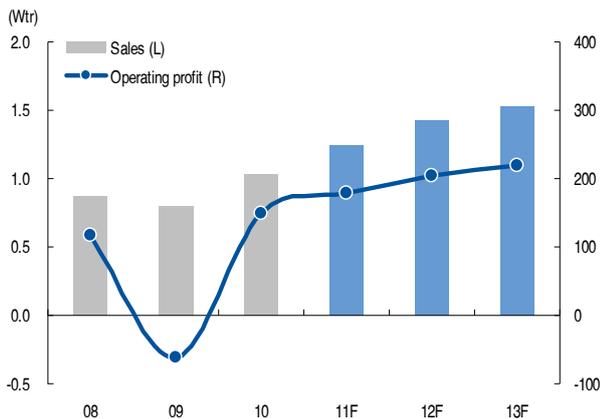
Building on its know-how in 12-inch wafer production, LG Siltron started to produce solar cell-use wafers in 2009 and LED-use sapphire wafers in 2010, creating synergies with other LG Group affiliates engaged in the solar cell and LED businesses. We expect LG Siltron's earnings volatility to decrease thanks to its diversified business portfolio, and its profile within the group should strengthen on the back of vertical integration in the solar cell and LED businesses.

LG Siltron is expected to go public in August~October. The market estimates the company's value at around W2tr, with a subscription amount of W600bn.

Despite the listing, LG Corp. should not suffer from stock dilution (LG Siltron's largest shareholder), as LG Corp. will keep its equity stakes, while Vogo Fund and KTB will each put 30% of their stockholdings on the market.

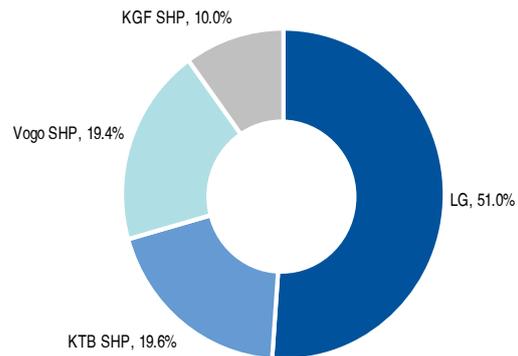
LG Corp.'s NAV reflects the value of LG Siltron based on its P/E multiple, not its book value. Once LG Siltron's earnings rise further, and the market enters an up-cycle as predicted, the company should drive LG Corp.'s NAV growth.

Figure 42. LG Siltron's sales and operating profit



Source: Daewoo Securities Research

Figure 43. LG Siltron's ownership structure



Source: Company data, Daewoo Securities Research

3) Abundant cash and new businesses

Strong cash flows to help LG Corp. advance into new businesses

We expect LG Corp.'s cash holdings to continue to expand thanks to dividends, brand royalties and rental income from its subsidiaries. Such robust cash flows should enable the company to invest in new businesses.

LG Group is taking a two-track approach to solar cells, simultaneously operating 1) a crystalline silicon solar cell business (ingot/wafer (LG Siltron) → solar cell/module (LG Electronics) → system (LG CNS) and power station (LG Solar)) and 2) a thin-film solar cell business (glass substrate (LG Chem) → solar cell (LG Display) → power station (LG Solar)). LG Group's investments in LG Solar signify the group's intent to expand its solar cell segment and create synergies among subsidiaries, including LG Chem, LG Siltron and LG CNS.

Although there are still uncertainties, LG Group's solar cell business should expand once the industry starts to pick up.

Table 22. Cash flow of LG Corp. (Wbn)

	FY05	FY06	FY07	FY08	FY09	FY10	FY11F
Cash Inflow	300.8	302.4	330.3	473.7	455.1	590.7	605.4
Own business	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Brand royalty	135.0	139.3	164.2	192.0	223.8	252.8	283.3
Rental income	20.3	33.4	37.9	39.4	49.4	58.3	61.2
Dividend income	145.4	129.6	128.3	242.3	182.0	279.6	260.9
Cash Outflow	137.9	184.1	224.0	239.5	291.8	300.8	314.6
COGS	0.0	0.0	0.0	0.0	0.0	0.0	0.0
SG&A expense	81.6	90.6	127.6	99.6	142.2	115.9	115.9
Dividend payout	44.1	87.7	87.7	131.5	131.6	175.5	189.5
Financial expense	12.2	5.8	8.7	8.5	18.0	9.5	9.2
Net cash flow	162.9	118.3	106.4	234.2	163.3	289.9	290.8
Net cash flow before dividend payout	207.0	206.0	194.1	365.7	294.9	465.3	480.3

Source: Daewoo Securities Research

5. Earnings forecast

We expect LG Corp. to deliver 2011 operating revenue and operating profit of W627.8bn (up 8.9%) and W508.2 (up 6.5%), respectively.

Recently, LG Chem shares (which account for 40% of LG Corp.'s NAV) have rallied strongly, thanks to: 1) widening chemical spreads, 2) aggressive capacity expansion (mid- to large-sized cells), and 3) better-than-expected 1Q earnings. Although the company's share price is correcting, its planned entry into the polysilicon market and the possible sales expansion of 3D retarders (used in 3D TVs) should drive its earnings further; these factors will likely lead to an upward revision to our earnings projections for the company. Moreover, we project that LG Chem's petrochemicals division—which led the company's significant earnings growth in 1Q—will continue to report strong earnings until 3Q11, thanks to tight supply and capacity expansion.

LG Electronics swung to positive territory in 1Q11

LG Electronics has reported disappointing operating results due to sluggish handset sales. Moreover, the profitability of LG Electronics' home appliance and air conditioner businesses deteriorated due to higher raw material prices. However, profitability should improve steadily thanks to new product launches and cost-cutting efforts. LG Electronics' operating profit came in at W130.8bn in 1Q11, swinging to positive territory after three consecutive quarters of losses. We are also upbeat on the company's earnings in 2Q and beyond, as handset and TV units will likely deliver better earnings going forward, and air conditioner sales should pick up full swing towards summer.

LG U+ has strengthened its business markedly since the merger between wired and wireless businesses in 2010, steadily increasing the number of subscribers and reporting better earnings.

Table 25. Quarterly earnings forecast for LG Corp.

(Wbn)

	2010					2011F					FY11 1Q growth	
	1Q	2Q	3Q	4Q	Annual	1QF	2QF	3QF	4QF	Annual	QoQ	YoY
Operating revenue	346.9	85.7	76.4	81.6	590.7	372.6	92.3	88.3	89.9	643.1	356.8	7.4
Dividends	279.6	0.0	0.0	0.0	279.6	297.7	0.0	0.0	0.0	297.7	-	6.5
Brand royalty	53.1	71.1	61.2	67.4	252.8	60.3	77.2	71.9	73.9	283.3	-10.5	13.7
Rental	14.2	14.7	15.2	14.1	58.3	14.5	15.2	16.4	16.0	61.2	2.5	1.9
Operating expense	23.7	25.3	36.2	30.7	115.9	27.4	28.2	32.3	31.7	119.6	-10.7	15.5
SG&A expenses	23.7	25.3	36.2	30.7	115.9	27.4	28.2	32.3	31.7	119.6	-10.7	15.5
Other	11.6	0.0	0.0	0.9	12.5	0.0	1.0	1.0	1.0	1.0	-	-
Operating Profit	334.8	60.4	40.3	51.8	487.2	345.2	64.1	56.0	58.2	523.5	566.8	3.1
Non-operating profit	-3.5	-2.9	-1.8	-1.6	-9.8	-2.3	-2.1	-1.9	-2.0	-8.3	-	-
Pretax profit	331.3	57.5	38.5	50.2	477.4	342.8	62.1	54.1	56.3	515.2	583.6	3.5
Net profit	311.8	43.0	28.7	37.6	421.1	256.3	46.4	40.4	42.1	385.2	581.6	-17.8

Source: Daewoo Securities Research

6. Financial position and risk factors

1) Free cash flow continues to rise despite higher capex and dividend payments

Free cash flow continues to rise

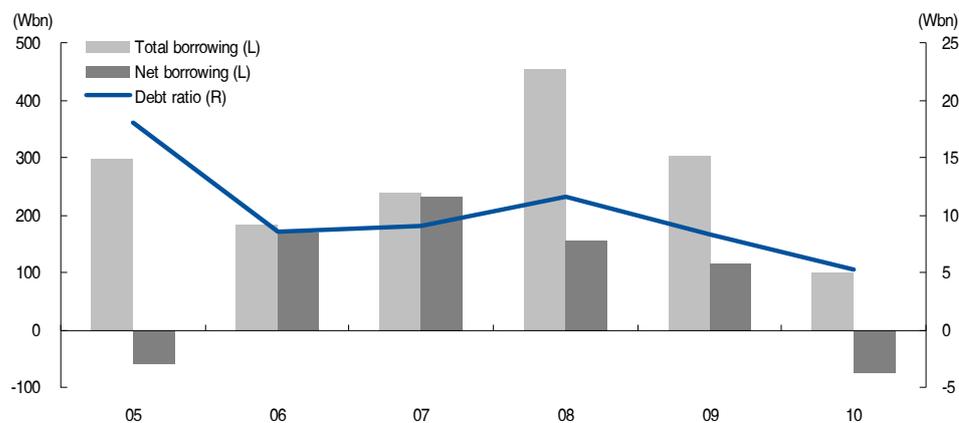
LG Corp.'s free cash flow (FCF) has been rising since 2008, despite higher capex (due to the construction of LG Gasan Digital Center and an office building in Gwanghwamun) and dividend payments. We believe that steady revenue growth and tight cost control helped the company generate strong cash flow.

LG Corp. should continue to report a considerable amount of FCF in 2011, given its brand royalties and rental income, in addition to huge dividends (W270bn) already received from its subsidiaries. As net borrowings have been declining since 2007, LG Corp.'s financial position should further stabilize.

2) Strong financials to reduce risk exposure

Holding companies are constantly exposed to financial risks, as they 1) assume responsibilities for new group businesses, and 2) subsidiaries' earnings may fluctuate wildly. However, LG Corp. can control its cash flow thanks to its diverse revenue streams (generated from its high-quality assets) and tight control over its subsidiaries. Thus, the company should be able to meet irregular financial needs that may arise in the future.

Figure 44. LG Corp.'s borrowings and debt ratio trends



Source: Daewoo Securities Research

LG Corp. (003550 KS /Buy/TP: W130,000)

Income Statement (Summarized)				
(Wbn)	12/10	12/11F	12/12F	12/13F
Sales	591	605	684	724
Cost of Goods Sold	0	0	0	0
Gross Profit	591	605	684	724
SG&A	116	116	134	141
Operating Profit	475	489	550	583
Non-Operating Income	3	-6	-6	-6
Interest Income/Expense	-9	-6	-6	-6
F/X-Related Gain/Loss	0	0	0	0
Equity Method Gain/Loss	0	0	0	0
Asset Disposal Gain/Loss	12	0	0	0
Other Non-Operating Profit/Loss	1	0	0	0
Pretax Profit	477	484	544	577
Tax	56	57	64	68
Profit from Continuing Operation	421	427	480	509
Profit from Discontinued Operation	0	0	0	0
Tax Effect	0	0	0	0
Net Profit	421	427	480	509
Residual Income	421	427	480	509
EBITDA	484	490	550	583
Free Cash Flow	402	395	487	513
Gross Profit Margin (%)	100.0	100.0	100.0	100.0
EBITDA Margin (%)	82.0	80.9	80.4	80.5
Operating Margin (%)	80.4	80.9	80.4	80.5
Net Margin (%)	71.3	70.5	70.1	70.3

Cash Flow (Summarized)				
(Wbn)	12/10	12/11F	12/12F	12/13F
Cash Flow from Operating Activities	402	395	487	513
Net Profit	421	427	480	509
Non-Cash Income and Expense	-207	0	0	0
Tangible Assets Depreciation	9	0	0	0
Intangible Assets Depreciation	1	0	0	0
Others	-217	0	0	0
Chg in Working Capital	188	-33	7	3
Chg in Accounts Receivable	0	0	0	0
Chg in Inventories	0	0	0	0
Chg in Accounts Payable	0	0	0	0
Others	188	-33	7	3
Cash Flow from Investment Activities	-81	-181	-317	-341
Chg in Tangible Assets	0	0	0	0
Chg in Intangible Assets	-1	0	0	0
Chg in Investment Assets	-80	-233	-307	-336
Others	0	51	-10	-4
Cash Flow from Financing Activities	-338	-237	-164	-170
Chg in Borrowings	-200	-61	12	6
Chg in Equity	-138	-176	-176	-176
Dividends	-175	-176	-176	-176
Others	0	0	0	0
Chg in Cash	-17	-24	6	3
Beginning Cash Balance	77	61	37	43
Ending Cash Balance	61	37	43	45

Source: Company data, Daewoo Securities Research estimates

Balance Sheet (Summarized)				
(Wbn)	12/10	12/11F	12/12F	12/13F
Current Assets	202	117	135	143
Cash and Cash Equivalents	61	37	43	45
Accounts Receivable	0	0	0	0
Inventories	0	0	0	0
Other Current Assets	142	80	92	97
Non-Current Assets	7,137	7,370	7,677	8,013
Investment Assets	7,118	7,350	7,658	7,994
Property, Plant and Equipment	13	13	13	12
Intangible Assets	7	7	6	6
Total Assets	7,340	7,486	7,811	8,155
Current Liabilities	210	167	176	180
Accounts Payable	0	0	0	0
Short-Term Debt	0	0	0	0
Current Long-Term Debt	100	100	100	100
Other Current Liabilities	110	67	76	80
Non-Current Liabilities	156	95	107	114
Bonds	0	0	0	0
Long-Term Debt	0	0	0	0
Other Non-Current Liabilities	156	95	107	114
Total Liabilities	366	262	283	294
Paid-In Capital	879	879	879	879
Capital Surplus	2,408	2,408	2,408	2,408
Retained Earnings	3,641	3,892	4,196	4,529
Stockholders' Equity	6,973	7,224	7,528	7,861

Forecasts/Valuations (Summarized)				
	12/10	12/11F	12/12F	12/13F
P/E (x)	36.5	36.7	32.6	30.7
P/CF (x)	35.7	37.1	33.0	31.1
P/B (x)	2.2	2.2	2.1	2.0
EV/EBITDA (x)	31.2	31.6	28.1	26.5
EPS (W)	2,394	2,427	2,728	2,894
CFPS (W)	2,444	2,428	2,730	2,896
BPS (W)	39,613	41,040	42,768	44,662
DPS (W)	1,000	1,000	1,000	1,000
Payout Ratio (%)	-	41.2	36.7	34.6
Dividend Yield (%)	1.2	1.1	1.1	1.1
Sales Growth (%)	-66.6	2.5	13.0	5.9
EBITDA Growth (%)	-70.0	1.1	12.3	6.0
Operating Profit Growth (%)	-70.1	3.1	12.3	6.0
EPS Growth (%)	-72.6	1.4	12.4	6.1
Accounts Receivable Turnover (x)	-	-	-	-
Inventory Turnover (x)	-	-	-	-
Accounts Payable Turnover (x)	-	-	-	-
ROA (%)	5.5	5.8	6.3	6.4
ROE (%)	5.9	6.0	6.5	6.6
ROIC (%)	-	26.3	24.5	22.2
Liability to Equity Ratio (%)	5.3	3.6	3.8	3.7
Current Ratio (%)	96.3	69.9	76.7	79.2
Net Debt to Equity Ratio (%)	-1.1	0.0	-0.2	-0.3
Interest Coverage Ratio (x)	30.6	44.1	48.2	50.9

SK Holdings (003600 KS)

Buy (Initiate)

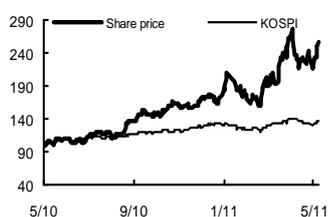
Target Price (12M, W)	280,000
Share Price (06/01/11, W)	207,500
Expected Return (%):	34.9
EPS Growth (11F, %)	77.7
Market EPS Growth (F, %)	26.5
P/E (F, x)	8.6
Market P/E (F, x)	10.8
KOSPI (11F/06/01,p)	2,141.34
Market Cap (Wbn)	9,745
Shares Outstanding (mn)	47
Avg Trading Volume (60D, '000)	551
Avg Trading Value (60D, Wbn)	98
Dividend Yield (11F, %)	0.9
Free Float (%)	54.2
52-Week Low	81,900
52-Week High	222,500
Beta (12M, Daily Rate of Return)	1.6
Price Return Volatility (12M Daily,%,SD)	2.1
Foreign Ownership (%)	29.9

Major Shareholder(s):

SK C&C et al. (32.56%)
Treasury shares (13.22%)

Price Performance

(%)	1M	6M	12M
Absolute	8.1	59.6	143.8
Relative	10.4	48.6	112.5



Solid business portfolio

- Optimal business portfolio increasing the company's attractiveness as a holding company
- Earnings growth at core subsidiaries, including K Power and SK Innovation
- Initiate coverage on SK Holdings with a Buy rating and a TP of W280,000

We initiate our coverage on SK Holdings with a Buy call and a target price of W280,000. We derived our target price using sum-of-the-parts valuation methodology by subtracting net borrowings from the sum of the present values of rental/royalty incomes and the value of investments in the company's nine subsidiaries.

Our investment recommendation is premised on the following.

1) Optimal business portfolio

The energy/chemical market has been recovering, and the SK Group's energy/chemical business is vertically integrated (from oil refining to the petrochemical business). The telecom business is expected to continue to post robust earnings thanks to its superior brand power, service quality, and customer loyalty, even though the market is volatile and experiencing rapid technological changes, particularly in smartphones.

Since the company is mostly composed of subsidiaries in stable industries, including gas and power generation, it will maintain solid business performance in the mid- to long term, in our view.

2) Expansion of earnings at core subsidiaries, including SK Innovation and K-Power

Given that earnings at SK Energy, SK Telecom, and K Power remain relatively stable, we expect SK Holdings to record steady divided income. In particular, SK Holdings has increased its stake in K-Power, which will likely post solid earnings and a high dividend payout ratio.

Royalty income, which is linked to sales, is projected to expand gradually. Sales growth at the energy/chemical business is expected to continue, while SK Telecom and SK Broadband are anticipated to identify new businesses and advance into overseas markets.

► Earnings & Valuation Metrics

FY	Sales (Wbn)	OP (Wbn)	OP Margin (%)	NP (Wbn)	EPS (W)	EBITDA (Wbn)	FCF (Wbn)	ROE (%)	P/E (x)	P/B (x)	EV/EBITDA (x)
12/09	767	372	48.5	284	5,988	378	234	4.1	14.9	0.6	18.4
12/10	1,273	903	70.9	647	13,622	909	249	8.8	10.2	0.9	10.6
12/11F	1,892	1,548	81.8	1,149	24,205	1,554	158	14.2	8.6	1.2	8.2
12/12F	2,090	1,769	84.7	1,332	28,051	1,775	141	14.4	7.4	1.0	7.2
12/13F	2,201	1,874	85.2	1,418	29,864	1,879	115	13.5	6.9	0.9	6.8

Source: Company data, Daewoo Securities Research estimates

1. Valuation

Present Buy rating with
a TP of W280,000

We initiate our coverage on SK Holdings with a Buy call and a target price of W280,000 and recommend the company as our top pick among holding companies.

We derived our target price using sum-of-the-parts valuation methodology by subtracting net borrowings from the sum of the present values of rental/royalty incomes and the value of investments in nine subsidiaries (four listed and five non-listed companies). The values of the subsidiaries were based on the market caps for listed companies and the book values for non-listed companies (except K-Power). We estimated the fair value of K Power by applying the industry average 2011F P/E of 8.6x <Table 28>.

Table 23. Calculation of target price for SK Holdings (Wbn)

	Value	Remarks
1. Present value of future income	2,414	
Operating value	-	A pure holding company
Brand royalty	2,414	Terminal growth rate=2%, WACC=11%
Real estate		Fair value
2. Investment asset value	17,225	
Listed subsidiaries	12,312	Based on market value
Non-listed subsidiaries	4,913	Based on book value
3. Total asset value (1+2)	19,639	
4. Net borrowings	3,061	End-4Q 2010
5. NAV (3-4)	16,578	
6. No. of shares ('000)	40,987	Outstanding shares
7. NAV per share (W)	404,471	
8. Target price (W)	280,000	Applied discount rate of 30%
Current price (W)	207,500	As of June 1, 2011
Discount rate (%)	48.7	
Upside potential (%)	34.9	

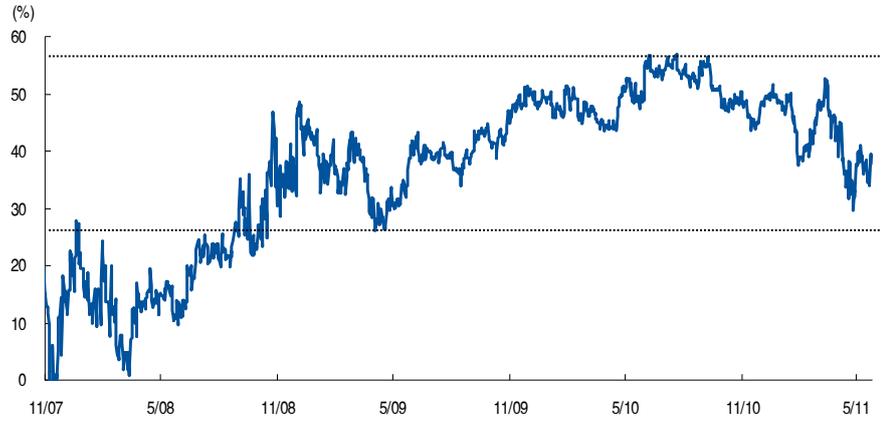
Source: Daewoo Securities Research

Table 24. Estimated value of investment securities (Wbn)

	% of stake	Book value	Current price	Value	Remarks
Listed subsidiaries				12,312	
SK Innovation	33.0%		236,000	7,192	
SK Telecom	23.2%		160,000	3,000	
SK Networks	39.1%		11,500	1,117	
SKC	42.5%		65,200	1,004	
Non-listed subsidiaries				4,913	
K-Power	100.0%	660		3,401	Applied P/E of 8.6x (11F)
SK E&C	40.0%	457		457	
SK E&S	67.6%	419		419	
SK Shipping	100.0%	485		485	
SK Bio Pharmaceuticals	100.0%	150		150	

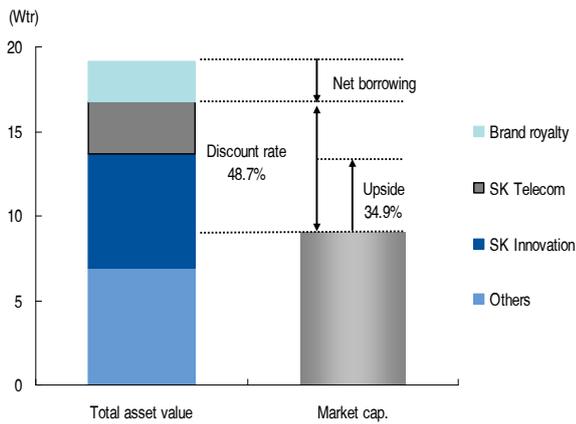
Source: Daewoo Securities Research

Figure 45. SK Corp.'s NAV discount rate trend



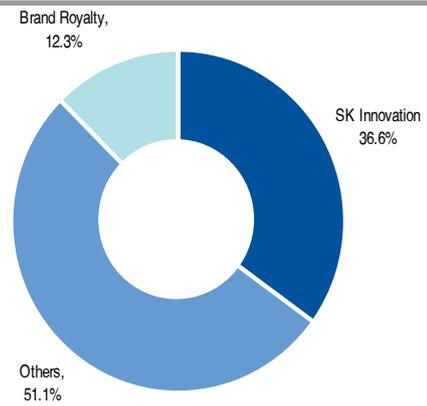
Source: Daewoo Securities Research

Figure 46. SK Corp.'s NAV breakdown



Source: Daewoo Securities Research

Figure 47. Contribution to SK Corp.'s NAV



Source: Daewoo Securities Research

2. Company overview

1) Analysis of corporate governance

SK Holdings, the SK Group's holding company, was established after SK Corp was split into SK Holdings and SK Energy in July 2007. In this process, stakes in SK Incheon Oil and DOPCO, and major manufacturing businesses (including petroleum, petrochemicals, lubricant, and oil field development) were transferred to SK Energy.

SK Holdings sold its stake in SK Gas to SK Chemicals in December 2010 and spun off its life science business on April 1st. SK Holdings now has nine subsidiaries—SK Innovation, SK Telecom, SK Networks, SK Shipping, SKC, SK E&S, SK E&C, K-Power, and SK Bio Pharmaceuticals—which hold stakes in related affiliates.

SK Group experienced an ownership challenge due to the low stakes held by its largest shareholder and his affiliates. However, the group bolstered the largest shareholder's ownership since converting to a holding company. SK Holdings' largest shareholder is SK C&C (31.8%), which is controlled by chairman Chey Tae-won with a 44.5% stake. Furthermore, given that SK Holdings' treasury shares account for 13.81% of its total outstanding shares, the largest shareholder's ownership appears solid.

The SK Group, which started out mainly as a textile business, acquired Korea Oil Corporation (currently SK Innovation) in 1980 and Korea Mobile Telecom (currently SK Telecom) in 1994. The two companies have emerged as the group's flagship energy/chemicals and information/telecom subsidiaries, respectively.

The SK Group has 87 affiliates, which engage in the energy/chemicals, information/telecom, construction, logistics, and financial businesses. The group has enhanced its management control of its subsidiaries by increasing its ownership stakes, while expanding its business areas through the subsidiaries. Given the relatively strong business relationships among major subsidiaries, we believe the group's overall business efficiency is sound.

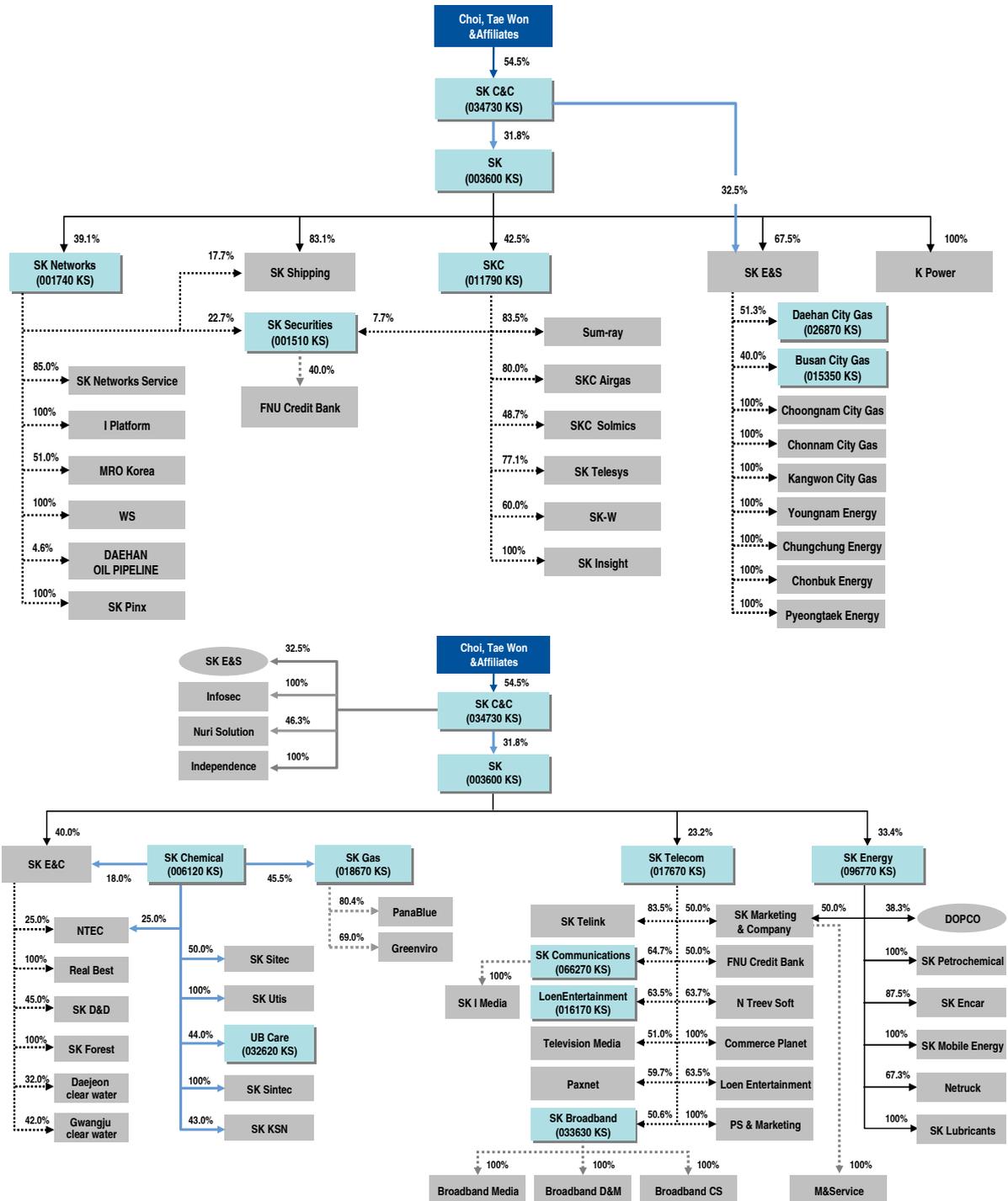
Energy/chemicals and information/telecom are the group's flagship subsidiaries

Table 25. Major subsidiaries by business type

Business	Listed	Non-listed
Holding company (1)	SK Corp. (003600 KS)	-
Energy / chemical (30)	SK Innovation (096770 KS)	
	SK Chemical (006120 KS)	
	SKC (082740 KS)	SK E&S, Choongnam City Gas, Daehan Oil Pipeline, Chonnam City Gas, Kangwon City Gas, K Power
	SK Gas (018670)	
	Daehan City Gas (026870)	
Information / telecommunication (24)	Busan City Gas (015350 KS)	
	SK Telecom (017670 KS)	
	Loen (016170 KS)	
	SK Communications (066270 KS)	SK Telesys, SK Telink
Construction / logistics / service (24)	SK Broadband (033630 KS)	
	SK C&C (034730 KS)	
Finance (1)	SK Networks (001740 KS)	SK Shipping, SK E&C, SK Marketing & Company FNU Credit Bank
Others (7)	SK Securities (001510 KS)	-
	SKC Solmics (057500 KS)	SK Biopham, SK-W
	UB Care (032620 KS)	

Source: Daewoo Securities Research

Figure 48. SK Corp.'s ownership structure



Source: Daewoo Securities Research

In November 2009, SK Networks sold its total stake in SK C&C when the company went public, and SK Telecom sold a portion of its stake. SK Telecom gradually reduced its remaining stake in SK C&C to 4.1% at end-2010 and sold the remainder to KB in early 2011.

SK Holdings sharply increased its stake in SK E&S to 67.5% in 2009, and sold its stake in SK Gas (45.5%) to SK Chemicals for W184.1bn in 2010, while purchasing SK Chemicals' stake in SK E&C. These share transactions put all affiliates, excluding SK Chemicals and SK C&C, under SK Holdings, consolidating SK Group's holding company structure.

Under SK Group's current corporate governance, SK C&C controls SK Holdings. Therefore, the two companies are likely to merge in the mid term in a way that minimizes the dilution of the largest shareholder's stake.

Split of SK Group would take some time

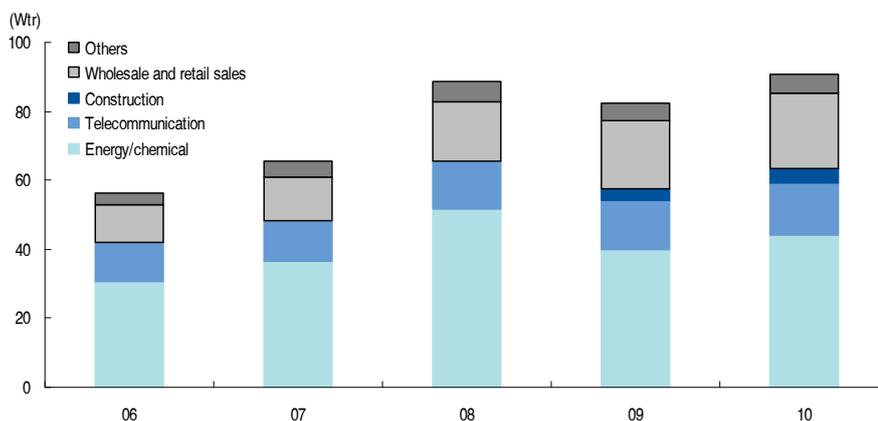
There is a possibility that SK Group will be split into two business groups—one owned by chairman Chey Tae-won and the other by his cousins. However, this would likely take some time due to the need for share transactions between the two parties.

Table 26. SK Holdings' purchase/disposal of stakes after conversion to holding company structure ()

Date	Details
2008	Purchased additional stakes in SK Telecom and SK Energy (W300bn) Acquired a stake in SK Gas through the exercise of call options (W90bn)
2009	Purchased a stake in SK E&C (W410bn) Increased its stake in SK E&S to 67.5%
2010	Purchased the remaining stake (35.0%) in K Power (W319.5bn) Purchased a stake in SK Shipping and participated in a rights offering (W295.5bn) Sold the stake in SK Gas (45.5%) to SK Chemicals for W184.1bn

Source: Daewoo Securities Research

Figure 49. SK Group's annual sales trend by business



Source: Daewoo Securities Research

2) Business analysis

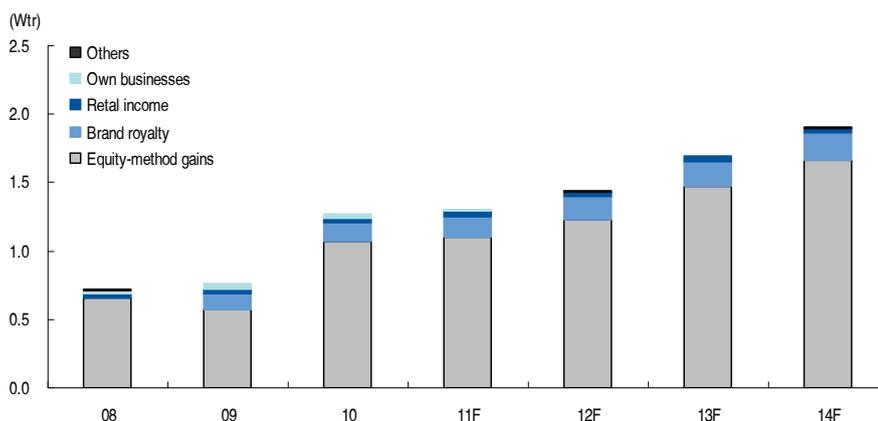
SK Holdings' earnings are composed of equity-method gains, dividends, brand royalties and rental income. Given that the company's operating subsidiaries have generated steady earnings based on their solid market positions, we expect equity-method gains and dividend income, which are the company's major revenue sources, to remain stable.

SK Holdings' average equity-method gains came from SK Energy, SK Telecom and K-Power

SK Holdings' average equity-method gains over the past five years (excluding SK Gas; stake sold in 2010) stood at around W900bn, most of which came from SK Energy, SK Telecom, and K-Power.

Operating revenue at SK Holdings comes mainly from equity-method gains, while cash flows are mostly attributable to dividends from subsidiaries. In particular, SK Telecom regularly reports significant annual profit growth and maintains a high payout ratio of around 50%, contributing to steady dividend income at SK Holdings. Furthermore, K Power has kept its payout ratio above 90%. As SK Holdings raised its stake in K Power from 65% to 100% in April 2010, its dividend income from K-Power, which posted a net profit of W337.7 (up 85% YoY) in 2010, surged YoY in 2011. As such, SK Holdings' 2011 total dividend income expanded sharply YoY to W565.6bn.

Figure 50. SK Corp.'s operating revenue trend



Source: Daewoo Securities Research

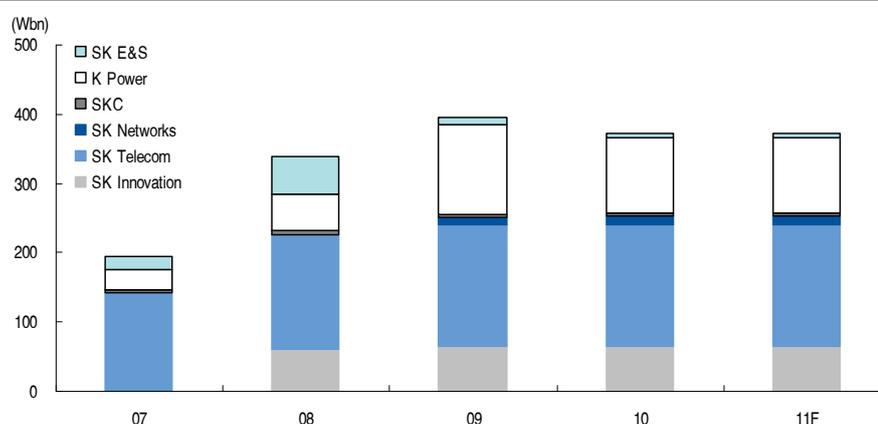
Since June 2009, SK Holdings has been collecting brand royalties from its subsidiaries (0.2% of consolidated sales, minus advertising expenses). Brand royalty income is largely attributable to SK Innovation, SK Telecom and SK Networks (69% in 2010).

SK's brand royalty income to steadily rise in light of sales growth at subsidiaries

Brand royalty income climbed by 10.6% YoY to W132.8bn in 2010. We forecast brand royalty income to steadily rise in light of sales growth at subsidiaries. As such, brand royalties will likely become a major revenue source for SK Holdings, stabilizing the company's profit structure.

Rental income contributes little to SK Holdings' earnings. Since the company rents its headquarters, its rental income is mostly offset by rental payments.

Figure 51. Dividend income from major subsidiaries



Source: Daewoo Securities Research

Table 27. Equity-method gains/losses by major subsidiary

(Wbn, %)

Subsidiaries	% of stake	Equity-method gains/losses				%			
		2007	2008	2009	2010	2007	2008	2009	2010
SK Innovation	41.3%	104.6	-15.4	-154.3	54.1	-256.8	12.3	123.1	36.3
SK Telecom	100.0%	0.0	0.0	16.5	55.3	0.0	0.0	-13.2	37.1
SK Networks	-	0.0	-6.2	1.7	19.5	0.0	5.0	-1.3	13.1
SKC	69.2%	1.5	1.5	1.5	2.5	-3.6	-1.2	-1.2	1.7
K Power	66.7%	5.2	1.6	3.0	3.3	-12.7	-1.3	-2.4	2.2
SK E&S	100.0%	-146.4	-5.6	-0.5	6.5	359.3	4.5	0.4	4.4
SK E&C	100.0%	-12.5	-12.9	5.0	5.0	30.7	10.4	-4.0	3.4
SK Shipping	100.0%	0.0	-41.9	-1.0	1.6	0.0	33.7	0.8	1.1
Others	-	6.9	-45.6	2.6	1.1	-16.8	36.6	-2.1	0.8

Source: Daewoo Securities Research

3. Major subsidiaries

1) Energy/chemical segment

SK Group's energy/chemical unit has a vertically-integrated structure

The SK Group's energy/chemical unit has a vertically-integrated structure (from oil refining, to petrochemical production, and to synthetic fiber production), enabling its entire business process (from stable feedstock acquisition to product selling) to progress smoothly. The SK Group's city gas, LPG, and private power generation businesses have maintained solid domestic market shares on the back of their monopolistic/oligopolistic positions. These businesses' solid performances have offset the earnings cyclicity at SK Holdings' oil refining and petrochemical subsidiaries.

SK Innovation split off its lubricant business in 2009 to establish SK Lubricants. In January 2011, SK Innovation's oil refining and petrochemical divisions were split off to establish SK Energy and SK Global Chemical. As a result, SK Innovation transformed into an intermediate holding company engaging in the E&P business.

As of end-2010, SK Innovation was participating in 31 oil projects in 16 nations (crude oil production is underway at nine reserves in seven nations) as well as four LNG projects. The company acquired crude oil and natural gas worth 54,000 BOE per day as of end-2010, which contributed W415.5bn (24.2% of operating profit) to the company's 2010 operating profit.

SK Energy's oil refining business has generated healthy earnings on the back of its solid domestic production capacity and market share, while improving earnings stability through profit structure diversification. SK Energy has an oil refining capacity of 1.115mn bpsd (a market share of 39.7%). In addition, the company has a competitive edge over its main domestic rival thanks to its superior domestic retail networks.

Although the petrochemical business is cyclical, we expect SK Global Chemical to maintain relatively high profitability in light of its ability to swiftly respond to market changes drawing upon: 1) an in-house supply of naphtha, 2) a vertically-integrated structure, and 3) economies of scale.

In a nutshell, we believe that the group's SK Innovation-led energy/chemical business should stay stable thanks to its vertically-integrated structure (from the E&P business to oil refining to the petrochemical business).

Table 28. Quarterly earnings forecast for SK Innovation

(Wbn, %)

		2010					2011				
		1Q	2Q	3Q	4Q	Annual	1QP	2Q	3Q	4Q	Annual
Sales	Total	10,201.1	11,303.7	10,166.8	12,196.0	43,867.5	14,480.8	13,715.6	15,050.7	14,027.5	57,341.9
	Refining	6,785.8	7,833.2	7,127.4	8,616.3	30,362.7	9,390.0	9,211.0	10,874.5	10,202.1	39,677.6
	Chemical	3,181.8	3,207.7	2,767.3	3,301.0	12,457.8	4,080.3	3,532.7	3,319.3	3,061.4	13,993.8
	E&P	168.9	187.6	206.0	214.6	777.1	339.4	324.2	289.5	264.1	1,217.3
	Lubricants	410.3	476.3	584.4	534.5	2,005.5	611.1	587.6	507.3	439.9	2,213.3
Operating profit	Total	357.8	579.6	325.0	443.2	1,705.6	1,193.3	632.7	942.5	829.9	3,598.4
	Refining	124.4	336.2	155.0	369.7	985.3	713.2	227.1	524.4	446.9	1,911.6
	Chemical	152.2	149.5	76.6	8.7	387.0	242.9	175.9	215.6	201.7	836.1
	E&P	82.9	99.6	110.9	116.4	409.8	148.2	141.6	126.4	115.3	531.5
	Lubricants	50.3	59.8	112.9	75.5	298.4	89.0	88.1	76.1	66.0	319.2
OP margin	Total	3.5	5.1	3.2	3.6	3.9	8.2	4.6	6.3	5.9	6.3
	Refining	1.8	4.3	2.2	4.3	3.2	7.6	2.5	4.8	4.4	4.8
	Chemical	4.8	4.7	2.8	0.3	3.1	6.0	5.0	6.5	6.6	6.0
	E&P	49.1	53.1	53.8	54.2	52.7	43.7	43.7	43.7	43.7	43.7
	Lubricants	12.2	12.6	19.3	14.1	14.9	14.6	15.0	15.0	15.0	14.4

Source: Company data, Daewoo Securities Research

K Power is one of SK Holdings' energy subsidiaries. K Power operates a LNG-fueled combined cycle thermal power plant in Gwangyang, Korea.

K Power was a joint venture established in December 2003 between SK Holdings (65%) and KEIH B.V. (BP's subsidiary, 35%). However, since SK Holdings acquired KEIH's 35% stake in April 2010, K Power became a wholly-owned subsidiary of SK Holdings.

K Power has two 537MW power plants, which commenced commercial production in 2006. The company's electricity is being sold through a bidding system at the Korea Power Exchange.

K-Power to maintain strong profitability

K-Power's profit stability is strong, as Korea's power market is operated on a cost-based pool system. The company's sales have been on the upswing, growing 26.1% YoY to W894.3bn in 2010 on higher electricity rates (both fixed and variable). Furthermore, both electricity demand and rates have been on the upswing since 2H09 alongside the economic recovery.

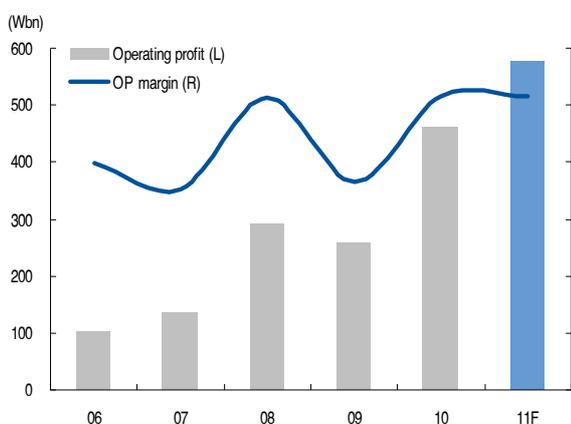
Meanwhile, in August 2004, K Power reached an agreement with Indonesia's Tangguh PSC Contractor Parties to directly import 500,000~600,000 tonnes of LNG per year (between 2006 and 2026) at a set rate. Normally, LNG import prices are based on international oil prices. As oil prices have risen since the deal was made, K-Power's cost competitiveness has improved relative to that of other private electricity companies that are purchasing LNG from KOGAS. This strong cost competitiveness has enabled K Power to display a higher OP margin than its peers.

Table 29. K-Power's annual earnings forecast (Wbn)

	2006	2007	2008	2009	2010	2011F
Sales	259.2	384.9	567.6	709.1	894.3	1,119.6
Gross profit	107.8	140.9	296.4	263.6	467.8	585.7
Operating profit	103.3	136.0	290.9	258.8	460.9	577.1
Non-operating profit	-22.2	-15.0	14.0	-16.7	-14.4	-15.1
Pretax profit	81.1	121.0	305.0	242.1	446.5	562.0
Net profit	58.8	87.7	221.3	183.5	337.8	425.1

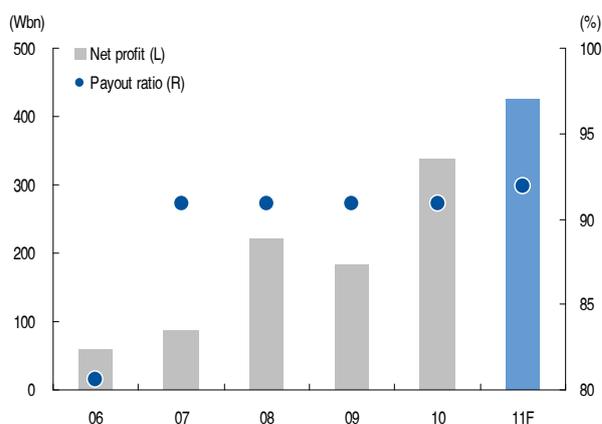
Source: Company data, Daewoo Securities Research

Figure 52. K-Power's operating profit and OP margin



Source: Daewoo Securities Research

Figure 53. K-Power's net profit and payout ratio



Source: Daewoo Securities Research

2) Information/telecommunication segment

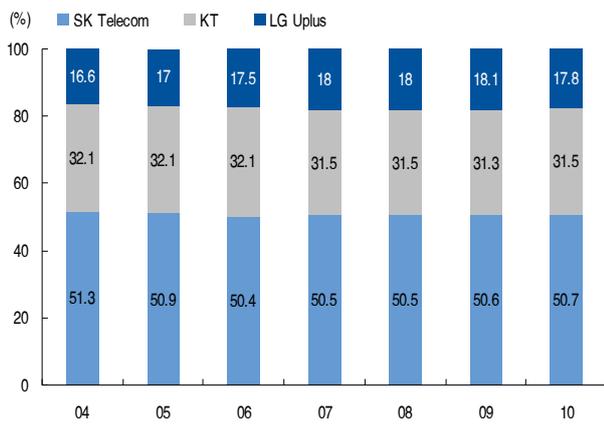
The SK Group’s information/telecommunication unit has provided superior technology and services thanks to its strong cash flow. SK’s IT companies should be able to stay robust, driven by a solid customer base, quality services, and good brand reputation.

The SK Group’s information/ telecommunication segment, which is led by SK Telecom, is a strong player in the domestic wired and wireless telecom service markets. Due to rapid changes in technology, intense competition, and regulations, the average OP margin at four major domestic IT companies plummeted to 14.3% in 2009 (from 22.7% in 2004).

SK Telecom to continue to generate healthy profit

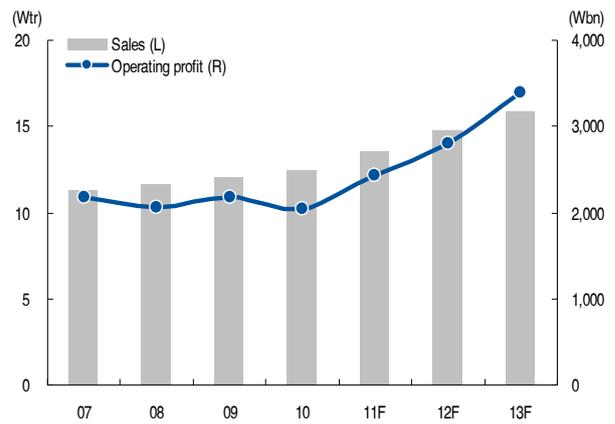
However, SK Telecom performed relatively well on the back of stable earnings and high profitability, generating EBITDAs of W4.3tr in 2009 and 2010. The company’s profits may deteriorate due to stiff marketing competition (related to new services and bundling services) and rate cut pressure from the government and civil groups. Still, we expect SK Telecom’s profit generation to continue to be healthy.

Figure 54. Market share trend of domestic mobile service providers



Source: Daewoo Securities Research

Figure 55. SK Telecom’s sales and operating profit



Source: Daewoo Securities Research

3) Construction and logistics segment

The SK Group's construction and logistics companies have grown on the back of orders from its affiliates and are now positioning themselves as solid domestic players in their respective business areas.

SK E&C's earnings are relatively stable. In 2009, sales at the company's cyclical architecture division only accounted for 28.4% of total sales, while plant construction and civil works accounted for higher portions. In addition, orders from affiliated companies made up 16.1% of sales in 2009 (26.2% in 2008).

In an attempt to boost its growth potential, SK Networks is diversifying its business portfolio to include overseas mining resource development, leisure, and real estate development. To expand into the overseas mining resource business, SK Networks acquired 85.5mn shares of MMX (a Brazilian iron ore mining/processing/selling company) at W799.4bn (approximately US\$700mn) in October 2010. In February 2011, SK Networks acquired the coal mining business of SK Innovation as part of the SK Group's E&P business portfolio adjustment efforts.

SK Networks has also been expanding into leisure, real estate development, and duty-free shop businesses since it acquired Walkerhill Inc. in 2009 and the Pinx Resort in Jeju in 2010. We believe that the company's new investments are crucial to boosting business diversification and long-term growth.

SK Shipping boasts a diversified fleet, which includes crude oil/petrochemical carriers and LNG carriers. However, the company's bulk shipping business is stagnant due to the market slowdown, while its U.K. subsidiary is facing laggard earnings and weak financial positions.

The company's U.K. subsidiary posted sales of W368bn and a net loss of W146.3bn in 2010. As of end-2010, the company's balance sheet was negative, as its liabilities (W202.8bn) exceeded its assets (W121.4bn).

SK earnings will stabilize on the back of steady operations

The subsidiary raised capital of W336bn in December 2010 with investments from foreign-invested funds and SK Holdings), and the charter parties for two loss-making vessels are scheduled to expire in April 2011. Meanwhile, the parent company is unlikely to provide further support given massive changes to its fleet-management policy. Although profitability recovery is slow due to the sluggish tanker and bulk shipping markets, SK Shipping turned profits at all of its business divisions in 2010 (OP margin of 3.0%). In light of an increase in vessel supply (resulting from an increase in VLCC deliveries and the expansion of bulk shipping tonnages), the shipping market is unlikely to pick up dramatically in the near term. However, we believe that the company's earnings will stabilize on the back of steady operations.

Nevertheless, despite stable operations, SK Shipping has suffered large-scale net losses since 2008 due to derivatives-related losses as well as earnings deterioration at its U.K. and Singaporean subsidiaries. The U.K. subsidiary has engaged in the bulk shipping business since its founding in 1999. Since 2008, this subsidiary has reported large-scale losses for three years due to the cost burden of high-priced chartered vessels. As a result, the company has carried out four rights offerings since 2008 to raise capital of US\$370mn. Furthermore, SK Shipping's Singaporean subsidiary is in the red, affected by the stagnant shipping market and the resulting earnings deterioration.

SK Shipping is pushing to stabilize its operations by tightening risk control and replacing its management. The company's heavy cost burden is likely to ease gradually on the back of a decrease in operating leverage, a decline in chartered vessel costs, and the liquidation of derivatives products. We believe that SK Shipping's financials should improve in light of the company's strategic importance in the SK Group's shipping business, as well as the SK Group's active support (e.g., rights offering).

4) Life science segment

In a bid to improve the competitiveness of its life science business, SK Holdings split off the unit to establish SK Bio Pharmaceuticals on April 1, 2011.

Life science segment to serve as a new growth driver

SK Bio Pharmaceuticals' major business divisions include the custom manufacturing services (CMS) division and the drug development division (drugs treating the central nervous system, metabolic disease, and cancer).

The CMS division is engaging in producing and selling high-margin active pharmaceutical ingredients (APIs; used in new drug production at major pharmaceutical companies). The CMS division started operations in 2000 after constructing a commercial production facility in Daedeok Science Town in 1999. Although its profit margins are not high, the CMS division is generating sales of W30bn annually. As of now, the company is selling 40 types of APIs to major pharmaceutical firms (including Pfizer, Novartis, Roche, and Bristol-Myers Squibb).

On the drug development front, SK Bio Pharmaceuticals submitted an application for sales approval for YKP509 (an epilepsy treatment) to the U.S. F.D.A. The company developed the drug under a licensing deal with Johnson & Johnson and successfully completed clinical trials in the U.S. In addition, YKP3089 (an epilepsy and anxiety treatment) and a neuropathic painkiller are under development.

SK Holdings' life science business' profits are unlikely to soar anytime soon. However, the segment seems noteworthy, as the SK Group is likely to expand investments in the life science business to promote it as a new growth driver.

Table 30. SK Bio Pharmaceuticals' R&D activities

R&D projects	Period	R&D results	Remark
Epilepsy treatment	1993~	Higher efficacy but less side effects than existing drugs	Licensed out YKP509 technology
Epilepsy/anxiety treatment	2001~	Higher efficacy but less side effects than existing drugs; Effective for various diseases related to the central nervous system	IND filing with U.S. FDA Clinical trials underway
Neuropathic painkiller	2003~	Higher efficacy but less side effects than existing drugs; A next generation neuropathic painkiller	IND filing with U.S. FDA Clinical trials underway
Depression treatment	2003~	Depression treatment with superior efficacy and safety	IND filing with U.S. FDA
Irritable bowel syndrome treatment	2003~	New treatment for irritable bowel symptom	IND filing with U.S. FDA

Source: Company data, Daewoo Securities Research

4. Investment points

1) Well-diversified subsidiary portfolio

The SK Group boasts the leading positions in the domestic energy and telecom service markets.

SK Group is the leader of the domestic energy and telecom service markets

Despite swift changes in technology (e.g., the proliferation of smartphones) and high market volatility, earnings at telecom subsidiaries should be able to remain solid on the back of their strong brand power, quality services, and high customer loyalty.

The energy/chemical market has been on the recovery, and the SK Group's energy/chemical segment is vertically integrated (from oil refining to the petrochemical business). SK's energy/chemical business is likely to perform well in the mid- to long-term as its subsidiaries (e.g., LNG sales and private power generation company) should maintain stable operations.

SK Holdings is strengthening its governance of its subsidiaries by securing stable ownership stakes in them. Its subsidiaries are likely to generate solid equity-method gains, dividend income, and brand royalty income.

Furthermore, SK Holdings is aggressively pushing to advance into China. In 2008, SK Holdings purchased an office building (worth W300bn) in Shanghai to establish SK Property Management. Since then, SK Holdings has expanded into the E&P business, the gas station field, and telecom service markets in China. However, it seems premature to evaluate the company's Chinese operations. Going forward, given that the growth of the company's domestic operations has stagnated, its growth should hinge on the performances of affiliated companies, the development of renewable energy sources, and Chinese operations.

2) Profit generation at key subsidiaries to grow

SK Innovation, SKT and K Power to maintain stable earnings

Given that SK Innovation, SKT, and K Power maintain stable earnings, SK Holdings' annual dividend income is likely to stay stable. In particular, dividend income from K Power is likely to be strong in light of SK's increased ownership stake in the company, a high dividend payout ratio, and a bright mid-term earnings outlook.

SK Holdings' brand royalty income (which is linked to sales) is anticipated to progress on a modest upward trend. Sales at the energy and petrochemical segment are projected to increase amid rising oil prices, while SKT and SK Broadband are expanding their businesses through business diversification and overseas expansion.

5. Earnings outlook

In 2010, SK Holdings' equity-method gains surged to W921.3bn (from W371.4bn in 2009). As such, FY10 dividends are forecast to jump to W565.6bn (from W379bn in FY09).

This increase in equity-method gains is attributable to: 1) the strong oil refining and petrochemical markets, and 2) slowing earnings deterioration at construction and shipping subsidiaries. Although the construction and shipping subsidiaries are unlikely to recover sometime soon, we expect that SK Holdings' equity-method gains will remain on the upswing in light of the bright earnings outlook for the oil refining and petrochemical segment. The company's profit structure should remain solid, as: 1) SK Telecom and SK Innovation (major contributors to equity-method gains) are projected to generate significant net profits, and 2) SK Networks is improving profitability thanks to won appreciation.

*SK Innovation,
SK Telecom and
K Power to maintain
stable earnings*

Given that SK Innovation, SK Telecom, and K Power maintain stable earnings, SK Holdings' annual dividend income is likely to stay stable. In particular, dividend income from K Power is likely to be strong in light of SK's increased ownership stake in the company, a high dividend payout ratio, and a bright mid-term earnings outlook.

SK Holdings' brand royalty income (which is linked to sales) is anticipated to progress on a modest upward trend. Sales at the energy/chemical segment are projected to increase amid rising oil prices, while SK Telecom and SK Broadband are expanding their businesses through business diversification and overseas expansion.

Nevertheless, the earnings outlooks for SK Holdings' construction and shipping subsidiaries remain somewhat murky, though earnings are anticipated to pick up slightly.

Table 31. Quarterly earnings forecast for SK Corp.

(Wbn)

	FY10					FY11F					FY11 1Q growth	
	1Q	2Q	3Q	4Q	Annual	1QP	2Q	3Q	4Q	Annual	QoQ	YoY
Operating revenue	346.7	302.0	361.7	262.8	1,273.3	364.6	324.2	272.2	346.8	1,307.8	38.7	5.2
Operating sales	8.0	1.6	9.1	11.5	30.2	8.0	0.0	0.0	0.0	8.0	-30.2	0.0
Equity-method gains	299.7	256.3	311.0	205.0	1,072.0	328.6	256.1	223.6	297.0	1,105.3	60.3	9.6
Brand royalty	30.5	35.8	33.2	33.2	132.8	17.1	56.9	37.0	37.8	148.8	-48.5	-44.0
Rental income	8.1	8.1	8.1	8.3	32.6	9.4	9.4	9.5	9.5	37.9	13.9	15.9
Others	0.2	0.2	0.4	4.8	5.7	1.4	1.7	2.1	2.5	7.8	-70.3	506.1
Operating expenses	53.6	96.2	105.0	115.8	370.6	74.0	77.5	76.0	90.8	318.3	-36.1	38.1
Operating profit	293.1	205.8	256.7	147.0	902.7	290.7	246.6	196.2	256.0	989.4	97.7	-0.8
Non-operating net profit	-39.3	-36.3	-40.1	-113.1	-228.8	-39.0	-38.3	-39.0	-38.7	-155.0	-	-
Pretax profit	253.8	169.5	216.6	34.0	673.8	251.7	208.3	157.2	217.2	834.4	640.5	-0.8
Net profit	243.5	149.6	226.9	26.6	646.7	197.0	163.1	123.0	170.0	653.1	640.5	-19.1

Source: Company data, Daewoo Securities Research

6. Financial and risk analysis

1) Borrowings appear high but controllable

The value of the company's subsidiaries far exceeds its net borrowings

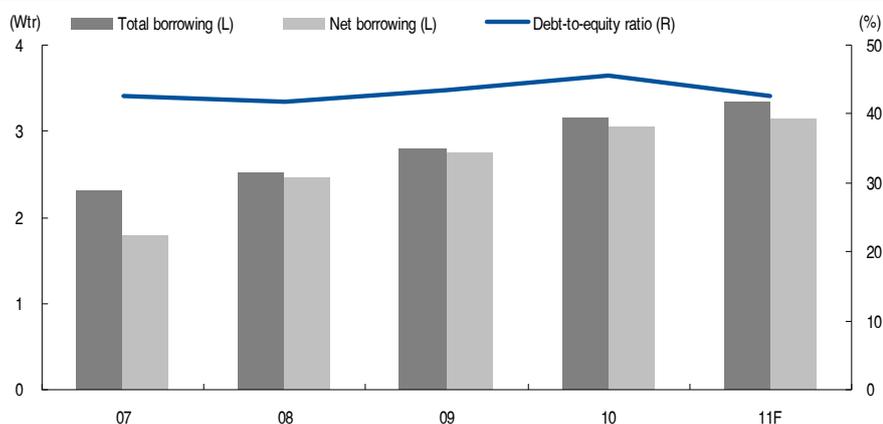
SK Holdings held total borrowings of W3.155tr, short-term borrowings of W769bn, and net borrowings of W3.061tr as of end-2010. Although net borrowings appear excessive, we believe that they are controllable, as: 1) the company can cover its SG&A expenses and interest expenses with dividends and brand royalty income from its subsidiaries; and 2) the company's subsidiary stakes far exceed its net borrowings.

2) Overall financial conditions are sound

SK Holdings' financial burden has continued to increase, as the company has acquired additional stakes in its subsidiaries. SK Holdings needs to hold at least one third of the total stake in a subsidiary—the threshold for approving a special resolution at a shareholders' meeting—to secure stable management control. As such, SK Holdings has steadily increased its stakes in SK Innovation and SK Telecom. As for SK Innovation, SK Holdings has already acquired a stake large enough to ensure management control. Meanwhile, SK Holdings' stake in SK Telecom remains at only 23.2%. SK Holdings plans to purchase additional shares of SK Telecom, as appropriate, depending on its cash generation and financial conditions.

In summary, we believe that SK Holdings' overall financial conditions are sound, as the company can raise funds from 1) the IPO of non-listed subsidiaries or 2) the sale of some stakes in its subsidiaries (excluding the stakes necessary to ensure management control).

Figure 56. Borrowings and debt-to-equity ratio



Source: Daewoo Securities Research

SK Holdings (003600 KS/Buy/TP: W280,000)

Income Statement (Summarized)				
(Wbn)	12/10	12/11F	12/12F	12/13F
Sales	1,273	1,892	2,090	2,201
Cost of Goods Sold	176	192	179	180
Gross Profit	1,097	1,700	1,911	2,021
SG&A	194	152	141	147
Operating Profit	903	1,548	1,769	1,874
Non-Operating Income	-229	-154	-155	-155
Interest Income/Expense	-156	-156	-158	-158
F/X-Related Gain/Loss	0	0	0	0
Equity Method Gain/Loss	0	0	0	0
Asset Disposal Gain/Loss	-73	0	0	0
Other Non-Operating Profit/Loss	0	2	2	2
Pretax Profit	674	1,393	1,614	1,718
Tax	27	244	282	301
Profit from Continuing Operation	647	1,149	1,332	1,418
Profit from Discontinued Operation	0	0	0	0
Tax Effect	0	0	0	0
Net Profit	647	1,149	1,332	1,418
Residual Income	647	1,149	1,332	1,418
EBITDA	909	1,554	1,775	1,879
Free Cash Flow	249	158	141	115
Gross Profit Margin (%)	86.1	89.8	91.4	91.8
EBITDA Margin (%)	71.4	82.1	84.9	85.4
Operating Margin (%)	70.9	81.8	84.7	85.2
Net Margin (%)	50.8	60.7	63.7	64.4

Cash Flow (Summarized)				
(Wbn)	12/10	12/11F	12/12F	12/13F
Cash Flow from Operating Activities	230	158	141	115
Net Profit	647	1,149	1,332	1,418
Non-Cash Income and Expense	-829	-996	-1,194	-1,305
Tangible Assets Depreciation	6	6	6	5
Intangible Assets Depreciation	0	0	0	0
Others	-835	-1,002	-1,200	-1,310
Chg in Working Capital	413	4	3	2
Chg in Accounts Receivable	1	-2	-2	-1
Chg in Inventories	1	-4	-3	-2
Chg in Accounts Payable	-1	0	0	0
Others	412	11	8	5
Cash Flow from Investment Activities	-451	-96	-214	-40
Chg in Tangible Assets	19	0	0	0
Chg in Intangible Assets	0	0	0	0
Chg in Investment Assets	-470	-96	-214	-40
Others	0	0	0	0
Cash Flow from Financing Activities	256	-46	-55	-66
Chg in Borrowings	336	34	25	14
Chg in Equity	-80	-80	-80	-80
Dividends	-80	-80	-80	-80
Others	0	0	0	0
Chg in Cash	35	15	70	9
Beginning Cash Balance	58	94	109	178
Ending Cash Balance	94	109	178	188

Source: Company data, Daewoo Securities Research estimates

Balance Sheet (Summarized)				
(Wbn)	12/10	12/11F	12/12F	12/13F
Current Assets	141	164	240	252
Cash and Cash Equivalents	94	109	178	188
Accounts Receivable	14	16	18	19
Inventories	26	30	33	35
Other Current Assets	8	9	10	11
Non-Current Assets	10,835	11,927	13,138	14,482
Investment Assets	10,670	11,768	12,984	14,333
Property, Plant and Equipment	118	112	106	101
Intangible Assets	48	48	48	48
Total Assets	10,977	12,091	13,377	14,734
Current Liabilities	844	856	865	870
Accounts Payable	1	1	1	1
Short-Term Debt	100	100	100	100
Current Long-Term Debt	669	669	669	669
Other Current Liabilities	74	86	95	100
Non-Current Liabilities	2,594	2,627	2,653	2,667
Bonds	2,386	2,386	2,386	2,386
Long-Term Debt	0	0	0	0
Other Non-Current Liabilities	208	242	267	281
Total Liabilities	3,438	3,483	3,518	3,537
Paid-In Capital	239	239	239	239
Capital Surplus	6,174	6,174	6,174	6,174
Retained Earnings	1,686	2,755	4,007	5,345
Stockholders' Equity	7,539	8,608	9,860	11,198

Forecasts/Valuations (Summarized)				
	12/10	12/11F	12/12F	12/13F
P/E (x)	10.2	8.6	7.4	6.9
P/CF (x)	10.2	8.4	7.2	6.8
P/B (x)	0.9	1.2	1.0	0.9
EV/EBITDA (x)	10.6	8.2	7.2	6.8
EPS (W)	13,622	24,205	28,051	29,864
CFPS (W)	13,747	24,334	28,171	29,978
BPS (W)	157,806	180,327	206,693	234,874
DPS (W)	1,950	1,950	1,950	1,950
Payout Ratio (%)	12.4	7.0	6.0	5.6
Dividend Yield (%)	1.4	0.9	0.9	0.9
Sales Growth (%)	66.1	48.6	10.5	5.3
EBITDA Growth (%)	140.4	71.0	14.2	5.9
Operating Profit Growth (%)	142.9	71.5	14.3	5.9
EPS Growth (%)	127.5	77.7	15.9	6.5
Accounts Receivable Turnover (x)	89.0	124.7	121.8	119.1
Inventory Turnover (x)	48.4	68.0	66.4	64.9
Accounts Payable Turnover (x)	980.2	1,671.7	1,632.8	1,595.6
ROA (%)	6.1	10.0	10.5	10.1
ROE (%)	8.8	14.2	14.4	13.5
ROIC (%)	-	-	90.9	54.0
Liability to Equity Ratio (%)	45.6	40.5	35.7	31.6
Current Ratio (%)	16.8	19.2	27.7	29.0
Net Debt to Equity Ratio (%)	40.6	35.4	30.2	26.5
Interest Coverage Ratio (x)	5.7	9.7	11.1	11.8

Doosan Corp. (000150 KS)

Buy (Initiate)

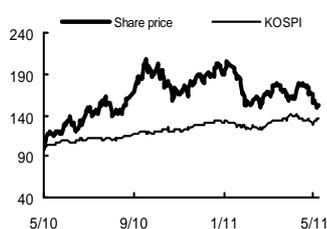
Target Price (12M, W)	W180,000
Share Price (06/01/11, W)	125,000
Expected Return (%):	44.0
EPS Growth (11F, %)	28.1
Market EPS Growth (F, %)	26.5
P/E (11F, x)	11.4
Market P/E (11F, x)	10.8
KOSPI (06/01/11, p)	2,141.34
Market Cap (Wbn)	3,135
Shares Outstanding (mn)	31
Avg Trading Volume (60D, '000)	186
Avg Trading Value (60D, Wbn)	25
Dividend Yield (11F, %)	2.4
Free Float (%)	32.3
52-Week Low	93,400
52-Week High	170,000
Beta (12M, Daily Rate of Return)	1.2
Price Return Volatility (12M Daily, %SD)	2.7
Foreign Ownership (%)	11.4

Major Shareholder(s):

Park Yong Kon et al. (37.14%)
Treasury Fund (29.56%)

Price Performance

(%)	1M	6M	12M
Absolute	-4.9	-12.3	29.5
Relative	-2.6	-23.3	-1.8



Lower subsidiary risks and strong operating activities

- Growing cash inflows to boost NAV
- Share price to re-rate as subsidiary risks dissipate steadily
- Initiate coverage with a Buy recommendation and a TP of W190,000

We initiate our coverage on Doosan Corporation (Doosan Corp.) with a Buy rating and a target price of W180,000. We derived our target price using sum-of-the-parts valuation methodology by subtracting net borrowings from the sum of the investment asset value and the present values of future rental and royalty incomes.

Our investment points are premised on the following:

1) Superior earnings as an operating holding company

Doosan Corp. is an operating holding company that also runs its own businesses (including Mottrol BG, Electro-Materials BG, etc.). Mottrol BG is expected to display double-digit growth in its hydraulic system business this year, and stable growth in its defense business. We expect the division's OP margin to continue to increase. Electro-Materials BG is anticipated to benefit from the growth of the LED and AMOLED markets.

2) Fewer group risks to reduce discounts

Doosan Corp.'s risks include Doosan E&C's PF debts (due to unsold houses) and financial risks related to the acquisition of Bobcat. However, the risks are not expected to erode the holding company's value in the long term.

The current share price volatility reflects the company's short-term risks. However, Doosan Corp.'s financial risks will be resolved going forward, in our view. Since Doosan Corp. has established dominant positions in the infrastructure support business (ISB) market, the company should be able to generate stable operating cash flows going forward.

3) Gains from the disposal of DIP Holdings

Doosan Corp. must complete the disposal of DIP Holdings by June 2014, according to its agreement with financial investors. In particular, the agreement includes a drag-along provision, which allows the majority shareholder to force minority shareholders to participate in the sale of the company. Accordingly, Doosan Corp. should be able to complete the disposal of DIP Holdings. The deal is expected to generate cash inflow of W500bn. The cash flow should enhance the company's financial stability, and free up funds to invest in new growth engines.

► Earnings & Valuation Metrics

FY	Sales (Wbn)	OP (Wbn)	OP Margin (%)	NP (Wbn)	EPS (W)	EBITDA (Wbn)	FCF (Wbn)	ROE (%)	P/E (x)	P/B (x)	EV/EBITDA (x)
12/09	953	-65	-6.8	232	7,598	-24	10	13.7	12.6	1.6	-113.3
12/10	1,531	253	16.5	262	8,536	295	-17	13.6	18.0	2.4	14.8
12/11F	1,969	381	19.4	337	10,931	431	128	15.5	11.4	1.7	8.1
12/12F	2,313	418	18.1	370	11,999	461	160	15.1	10.4	1.5	7.2
12/13F	2,740	570	20.8	504	16,344	606	266	17.9	7.6	1.3	5.2

Source: Company data, Daewoo Securities Research estimates

1. Valuation

Present Buy rating with a TP of W180,000

We initiate our coverage on Doosan Corporation with a Buy call and a target price of W180,000.

We derived our target price using sum-of-the-parts valuation methodology by subtracting net borrowings from the sum of the investment asset value and the present values of future rental and royalty incomes.

Currently, Doosan controls eight subsidiaries (two listed and six unlisted). The values of listed subsidiaries are based on their market caps, while those of unlisted companies are based on their book values. Meanwhile, we calculated the value of DIP Holdings in light of its earnings and recent issues <Table 36>.

Table 32. Calculation of target price for Doosan Corp. (Wbn)

	Value	Remarks
1. Present values of future income	2,084	
Operating value	1,649	EV/EBITDA: 7.0x
Brand royalty	264	Terminal growth rate=2%, WACC=11%
Rental income	170	Fair value
2. Investment asset value	3,288	
Listed subsidiaries	2,567	Based on market value
Unlisted subsidiaries	721	Based on book value
3. Total asset value (1+2)	5,372	
4. Net borrowings	212	End-4Q 2010
5. NAV (3-4)	5,160	
6. No. of shares ('000)	23,071	Outstanding shares
7. NAV per share (W)	223,657	
8. Target price (W)	180,000	Applied discount rate of 20%
Current price (W)	125,000	As of June 1, 2011
Discount rate (%)	44.1	
Upside potential (%)	44.0	

Source: Daewoo Securities Research

Table 33. Estimated value of investment securities (Wbn)

	% of stake	Book value	Current price	Value	Remarks
Listed subsidiaries				2,567	
Doosan Heavy I&C	41.3%		58,400	2,550	
Oricom	69.2%		11,700	17	
Unlisted subsidiaries				721	
Neoplux	66.7%	26		18	
Doosan Tower	100.0%	204		204	
Doosan Feed & livestock	100.0%	21		21	
Doosan Donga	100.0%	31		31	
N Shaper	100.0%	16		16	
DIP Holdings	100.0%	219		432	P/E of 10x; Discount of 30%

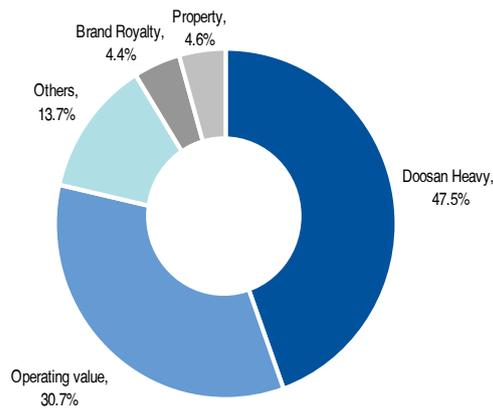
Source: Daewoo Securities Research

Figure 57. NAV discount rate trend for Doosan Corp.



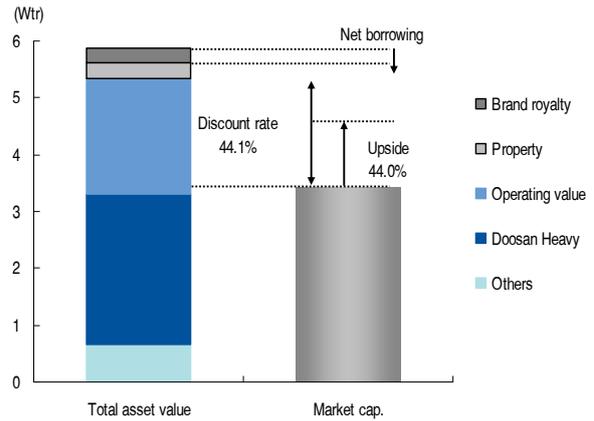
Source: Daewoo Securities Research

Figure 58. Doosan Corp.'s NAV breakdown



Source: Daewoo Securities Research

Figure 59. Contribution to Doosan Corp.'s NAV



Source: Daewoo Securities Research

2. Company overview

1) Introduction

Doosan Corp., the parent company of the Doosan Group

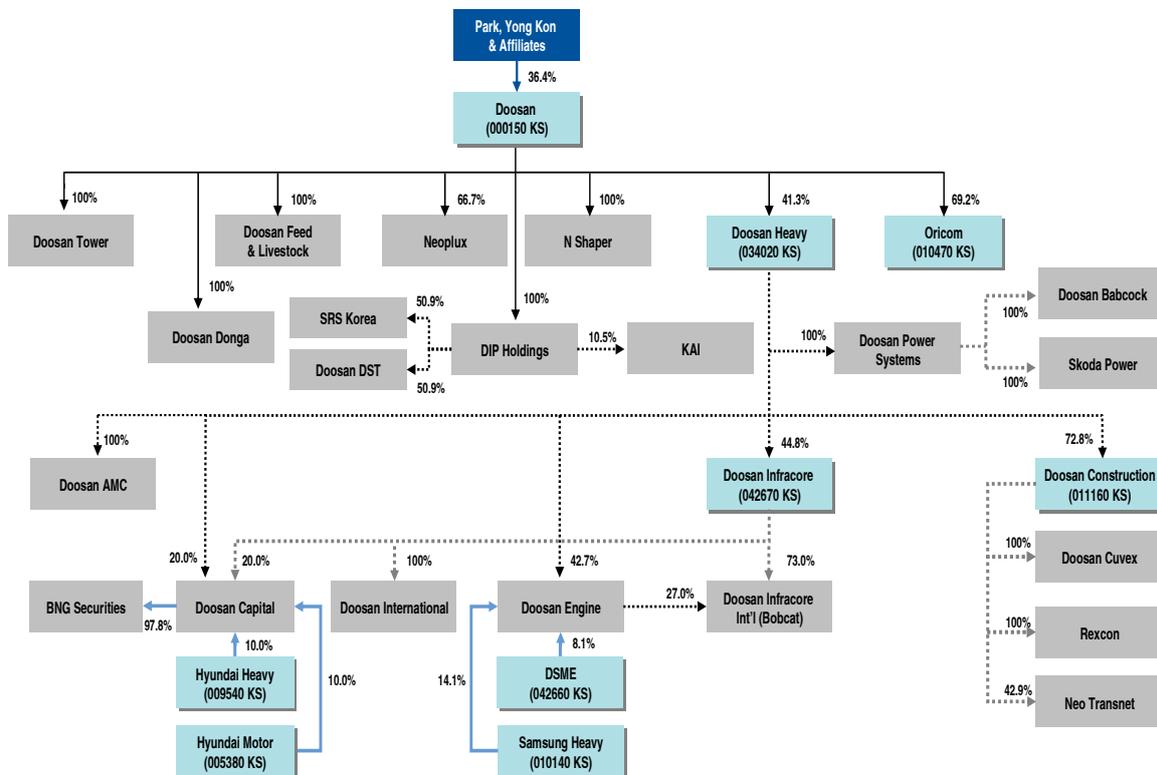
The Doosan Group has strongly pushed ahead with restructuring since it disposed of its beer business in 1998. The group acquired Hankook Heavy Industries (currently Doosan Heavy I&C) in 2001, Koryo Industrial Development (currently Doosan E&C) in 2003, and Daewoo Heavy Industries & Machinery (currently Doosan Infracore) in 2005.

Doosan Corp., which converted to an operating holding company on January 1, 2009, is the parent company of the Doosan Group.

Previously, Doosan Corp. engaged in various consumer goods businesses, including apparel, liquor, trading, electronic materials, packaging, publishing and animal feeds. However, the company has sold-off or split-off unprofitable divisions, significantly shrinking the scope of its business.

The company's current businesses, including electronic materials and hydraulic systems (merged in 2H10), are generating stable earnings. In addition, Doosan Heavy I&C (Doosan Corp.'s intermediate parent company) helps reduce financial risks on the back of its stable subsidiaries.

Figure 60. Doosan Corp.'s ownership structure



Source: Daewoo Securities Research

Doosan Group's businesses: consumer goods, construction, power plants and industrial facilities/equipment

2) Analysis of affiliates and corporate governance

The Doosan Group is the fifteenth largest corporate group in Korea in terms of total assets (as of April 2010). Doosan Group's businesses are largely divided into three areas: 1) consumer goods (Doosan Corp.), 2) power plants and industrial facilities/equipment (Doosan Heavy I&C), and 3) construction (Doosan E&C). As of November 2010, 136 affiliates (25 domestic and 111 overseas) are operating under the Doosan Group.

The heavy industries business, which encompasses power generation, industrial facilities, engines and machinery equipment, accounts for 70% of the group's sales. This stable business should continue to improve the group's financial strength.

Table 34. Major subsidiaries by business type

Type of business	Listed	Unlisted
Holding company (1)	Doosan Corp. (000150 KS)	-
Heavy industries (5)	Doosan Heavy (034020 KS) Doosan Infracore (042670 KS) Doosan Engine (082740 KS)	Doosan DST, Rexcon
Construction / Consumer goods(4)	Doosan Construction (011160 KS)	Doosan AMC, Doosan International, Doosan Feed & Livestock
Finance / Services (15)	Oricom (010470 KS)	DIP holdings, Doosan Cuvex, Doosan Donga, Neoplux Doosan Motor, Neo Trans, N Shaper, SRS Korea Doosan Tower, Doosan Bears, Donghyun Engineering Doosan Capital, B&G Securities, Neoplux PEF

Source: Daewoo Securities Research

3) Business analysis

A. Doosan Corp.'s own operating activities

Doosan Corp.'s business portfolio includes Electro-Materials BG, Mottrol BG, Glonet BU, and Information & Communications BU

Doosan Corp.'s business portfolio includes electronic materials (Electro-Materials BG), hydraulic systems (Mottrol BG), trading (Glonet BU), and IT (Information & Communications BU).

Electro-Materials BG uses copper foil, glass fiber, phenol resin and epoxy resin to produce phenol and epoxy copper-clad laminates (CCL), major raw materials for printed circuit boards (PCB).

Nearly every category of the electronic materials market experiences ups and downs. However, CCL products have been relatively immune from market fluctuations as PCBs are used in almost all electronic products (i.e., core components).

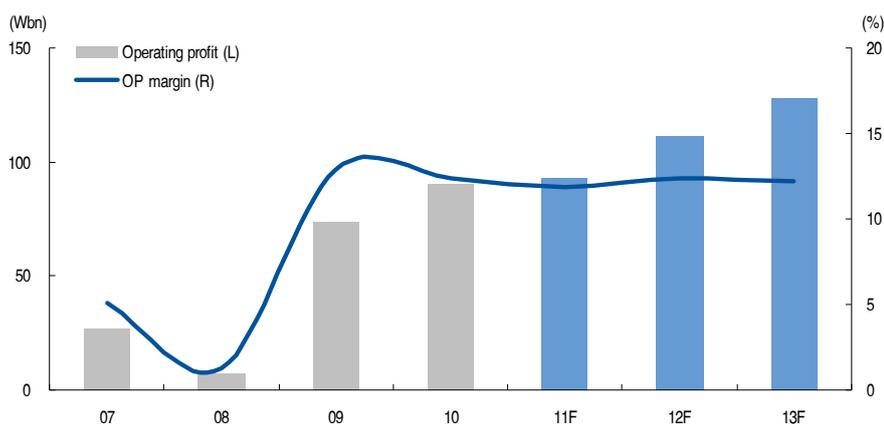
Since 2008, CCL sales have grown steadily in line with 1) demand recovery in the PCB market and 2) stabilization of raw material prices and F/X rates. In addition, sales of high-margin products have expanded, including package-use substrate materials, halogen-free CCL, flexible CCL (FCCL, material for flexible PCBs), metal CCL and organic light emitting diode (OLED).

Expansion of high-margin product sales has boosted Electro-Materials BG's profitability

LED TV sales growth is driving up demand for MCCLs. In addition, sales of FCCLs have also improved steadily, thanks to 1) larger sales of touch screen phones and LED products, 2) the use of FCCLs in LED laptops, and 3) new circuit design methods in line with the increasing thinness of LCD TVs. The expansion of high-margin product sales has boosted Electro-Materials BG's profitability.

Currently, about twenty companies, including LG Chem, Kingboard Chemical, Nanya, Matsushita, Hitachi and Nelco, are competing in the domestic market. Doosan has grown into one of the market leaders, and should maintain steady growth on the development of the electronic and IT industries.

Figure 61. Electro-Materials BG's OP and OP Margin



Source: Daewoo Securities Research

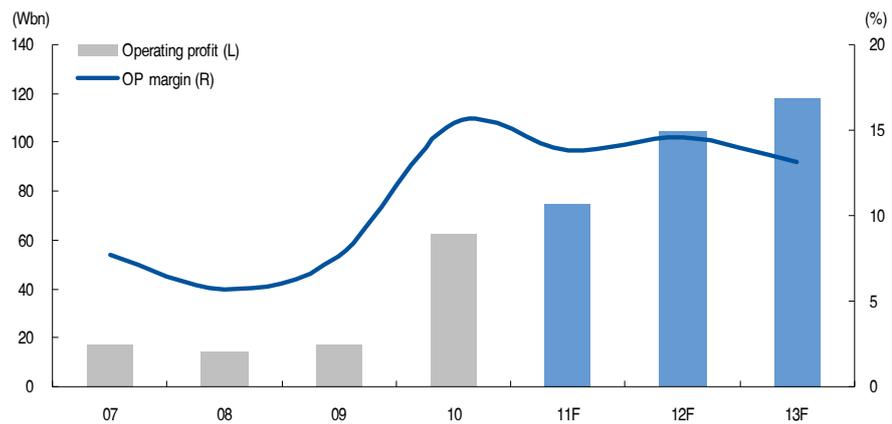
Mottrol BG to improve further on the diversification of its product portfolio and the increase in supplies to affiliates

On July 1, 2010, Doosan Corp. entered the hydraulic systems market by merging with Doosan Mottrol Holdings (a wholly-owned subsidiary) and Doosan Mottrol (a subsidiary of Doosan Mottrol Holdings). Mottrol BG is the domestic hydraulic systems market leader, and supplies hydraulic components to Doosan Infracore, Hyundai Heavy Industries and Volvo Korea. The division's 3-year EBITDA average stands at W20.6bn, with an OP margin of 7%. In particular, its sales grew by 79.2% YoY during 1Q~3Q10, posting an OP margin of 15.1%. Its performance is expected to improve further on the diversification of its product portfolio and the increase in supplies to affiliates.

Glonet BU imports and sells chemical ingredients, food materials, and bathroom furniture, and provides domestic and overseas logistic services. The division recorded sales of W132.6bn in 2008 and W178.8bn in 2009. However, its earnings contribution is insignificant due to low margins.

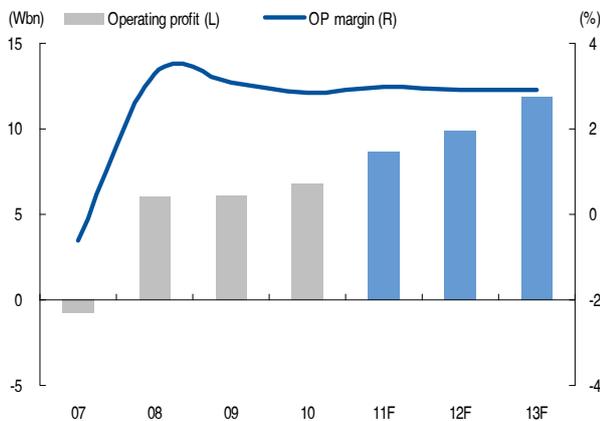
The Information & Communications BU provides comprehensive IT services to Doosan Group affiliates. The division has recently started to expand its customer base to overseas affiliates.

Figure 62. Mottrol BG's OP and OP Margin



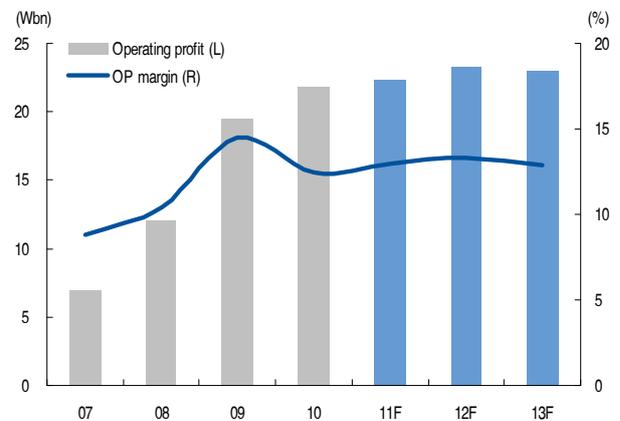
Source: Daewoo Securities Research

Figure 63. Glonet BU's OP and OP Margin



Source: Daewoo Securities Research

Figure 64. Information & Communications BU's OP and OP Margin



Source: Daewoo Securities Research

B. Holdings business

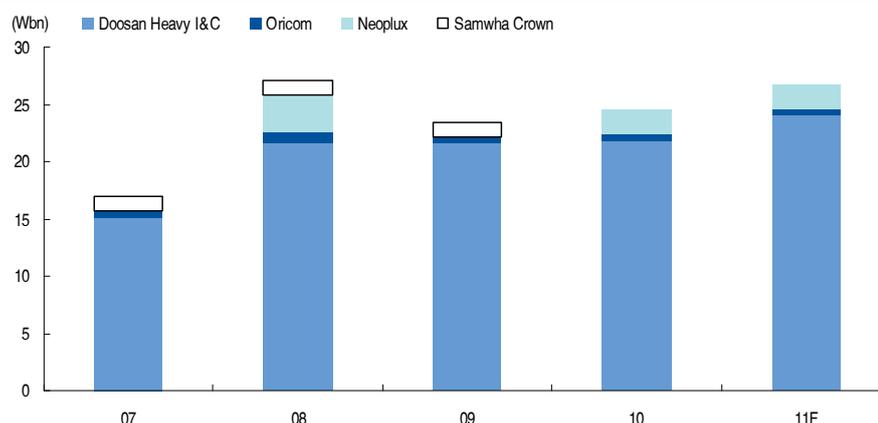
Doosan Heavy I&C to provide a stable cash flow

Doosan Corp. has a 41.3% stake in Doosan Heavy I&C. In light of Doosan Heavy I&C's competitiveness, market status, and stable second-tier subsidiaries, the company is projected to provide a stable cash flow to Doosan Corp.

Dividend income fluctuates in line with subsidiaries' earnings; Doosan Heavy I&C accounted for 89% of Doosan Corp's total dividend income in 2009. Considering Doosan Heavy I&C's robust performance and financial stability, Doosan Corp. should benefit from the stable inflow of dividend income going forward.

Since August 2009, Doosan Corp. has received brand royalties from subsidiaries. Given subsidiaries' sales and royalty rates (0.05~0.25% of sales), the company is projected to record royalty income of W28bn per annum. The income will likely help Doosan Corp. further diversify its revenue sources and improve cash flow.

Figure 65. Dividend income by major subsidiary



Source: Daewoo Securities Research

Table 35. Equity method income by major subsidiary

(Wbn, %)

Subsidiary	% of stake	Equity method income				%			
		2007	2008	2009	2010	2007	2008	2009	2010
Doosan Heavy I&C	41.3%	104.6	-15.4	-154.3	54.1	-256.8	12.3	123.1	36.3
DIP holdings	100.0%	0.0	0.0	16.5	55.3	0.0	0.0	-13.2	37.1
Doosan Motrol holdings	-	0.0	-6.2	1.7	19.5	0.0	5.0	-1.3	13.1
Oricom	69.2%	1.5	1.5	1.5	2.5	-3.6	-1.2	-1.2	1.7
Neoplux	66.7%	5.2	1.6	3.0	3.3	-12.7	-1.3	-2.4	2.2
Doosan Tower	100.0%	-146.4	-5.6	-0.5	6.5	359.3	4.5	0.4	4.4
Doosan Feed & Livestock	100.0%	-12.5	-12.9	5.0	5.0	30.7	10.4	-4.0	3.4
Doosan Donga	100.0%	0.0	-41.9	-1.0	1.6	0.0	33.7	0.8	1.1
Others	-	6.9	-45.6	2.6	1.1	-16.8	36.6	-2.1	0.8

Source: Daewoo Securities Research

3. Major subsidiaries

1) Heavy industries

Doosan Heavy I&C developed a stable business portfolio

Doosan Heavy I&C (034020 KS) has developed a stable business portfolio in the areas of power plants, forging and construction; the company is competitive in these areas and consequently possesses healthy market shares. The power plant business, which accounts for 60% of the company's sales, provides the following services: private power generation, co-generation, power plant performance improvement and equipment replacement. The company dominates the domestic power plant equipment market. Its overseas orders have also increased on 1) the expansion of the engineering, procurement and construction (EPC) businesses and 2) the acquisition of Babcock.

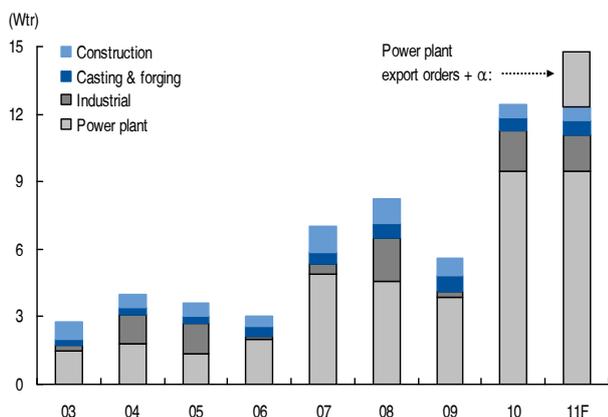
Doosan Infracore is improving rapidly thanks to the recovery of the Chinese market

Doosan Infracore (042670 KS) is one of the leading players in the construction machinery and machine tool markets. Its top line has expanded steadily in line with the construction machinery market boom in emerging markets. Although sales plunged amid the global financial crisis, earnings are improving rapidly thanks to the recovery of the Chinese market.

Doosan Engine appears healthy in light of robust EBITDA

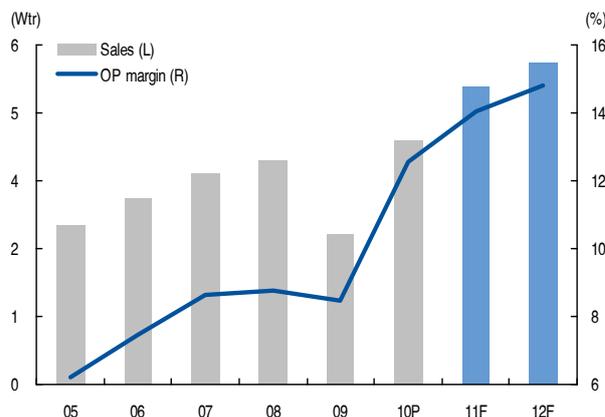
In the past, Doosan Engine (082740 KS) maintained sufficient order backlogs thanks to strong orders from shareholders (Samsung Heavy Industries and Daewoo Shipbuilding & Marine Engineering). Since 2H08, new orders have slowed in line with the shipbuilding market slump; and some orders have been canceled. In addition, the company's financial stability has degraded since 2008 due to the settlement of currency options and large-scale facility investments. However, its financial status still appears relatively healthy in light of robust EBITDA, shareholders' sound financial positions, and capital expansion through a rights offering of W276.3bn.

Figure 66. Order trend for Doosan Heavy I&C



Source: Daewoo Securities Research

Figure 67. Doosan Infracore's sales and OP margin



Source: Daewoo Securities Research

Doosan E&C's financial risks expanded recently due to an increase in unsold houses amid a housing market slump

2) Construction and consumer goods

Doosan E&C acquired and merged with Doosan Mecatec, a petrochemical plant equipment manufacturer (reactor, heat exchanger, etc.), on November 1, 2010. The merger ratio was 4.1 Doosan E&C shares for 1 Doosan Mecatec share. The deal increased Doosan Heavy I&C's stake in Doosan E&C from 54.6% to 72.8%.

Doosan E&C's profitability has improved steadily since the company spun off its less profitable non-construction businesses. However, its financial risks have expanded recently due to an increase in unsold houses amid a housing market slump.

Doosan E&C's 1H10 sales can be broken down into four segments: 1) civil engineering (21.3%), 2) construction (13.1%), 3) housing (64.6%), and 4) plant/others (1.1%). The company expects the merger with Doosan Mecatec to generate synergies, including 1) enhanced competitiveness in the plant market, 2) lower dependence on the housing business, and 3) participation in steel bridge construction projects (previously Doosan Mecatec's business).

4. Investment points

1) Fewer group risks to reduce valuation discounts

Doosan Corp.'s risks should not erode the holding company's value

Doosan Corp.'s risks include Doosan E&C's PF debts (due to unsold houses) and financial risks related to the acquisition of Bobcat. However, the risks are not expected to erode the holding company's value in the long term.

Bobcat should help Doosan Corp. develop footholds in North America and Europe. In addition, the company's brand recognition and competitiveness in the small construction equipment industry should improve.

Doosan E&C, the leader of the infrastructure support industry, is also anticipated to significantly contribute to Doosan Group's earnings. Thus, short-term financial risks will dissipate steadily, in our view.

The current share price volatility reflects the company's short-term risks. However, Doosan Corp.'s financial risks will be resolved going forward, in our view. Since Doosan Corp. has established dominant positions in the infrastructure support business (ISB) market, the company should be able to generate stable operating cash flows going forward.

2) Superior earnings as an operating holding company

Doosan's own businesses to display superior earnings

Doosan Corp. is an operating holding company that also runs its own businesses (including Mottrol BG, Electro-Materials BG, etc.). Mottrol BG is expected to display double-digit growth in its hydraulic system business this year, and stable growth in its defense business. We expect the division's OP margin to continue to increase. Electro-Materials BG is anticipated to benefit from the growth of the LED and AMOLED markets.

3) Gains from the disposal of DIP Holdings

Disposal of DIP Holdings to enhance Doosan's financial stability

In 2009, Doosan Corp. established DIP Holdings, a wholly owned subsidiary. DIP Holdings purchased a paper company from Doosan Infracore; thus, Doosan Infracore was able to meet the debt-to-EBITDA ratio requirement for DII. DIP Holdings holds 50.9% stakes in both Defense System & Technology and System Restaurant Service, and a 10.5% stake in Korea Aerospace Industries.

Doosan Corp. must complete the disposal of DIP Holdings by June 2014, according to its agreement with financial investors. In particular, the agreement includes a drag-along provision, which allows the majority shareholder to force minority shareholders to participate in the sale of the company. Accordingly, Doosan Corp. should be able to complete the disposal of DIP Holdings. The deal is expected to generate cash inflow of W500bn. The cash flow should enhance the company's financial stability, and free up funds to invest in new growth engines.

5. Earnings outlook

Profitability of Doosan Corp.'s operations to remain stable

Sales and profitability of Doosan Corp.'s own operations remain stable. Going forward, operating profit from Mottrol BG is projected to exceed that of the apparel business, which the company scrapped in 2011.

In addition, average annual brand royalties stand at W28bn (as of 2H09).

Its own operations are projected to generate operating cash inflow of around W98bn per annum over the next few years. Including dividend income from subsidiaries (W25bn) and brand royalties (W28bn), the company's annual cash inflow is estimated at the healthy level of W150bn.

Table 36. Quarterly earnings forecast for Doosan Corp.

(Wbn)

	2010					2011F				
	1Q	2Q	3Q	4Q	Year	1QP	2Q	3Q	4Q	Year
Sales	354.9	443.0	286.6	446.6	1,531.0	457.4	508.5	486.9	516.4	1,969.2
Operating expenses	291.6	338.0	249.2	399.4	1,278.3	368.4	394.3	386.7	438.8	1,588.2
Operating profit	63.3	105.0	37.3	47.1	252.7	89.0	114.2	100.2	77.6	381.0
Non-operating net profit	-2.1	-5.5	12.2	-5.7	-1.0	-0.3	0.2	1.6	-1.0	0.5
Pretax profit	61.2	99.5	49.6	41.4	251.7	88.8	114.4	101.8	76.5	381.5
Net profit	53.7	86.1	62.3	60.2	262.4	78.5	101.1	90.0	67.6	337.1

Source: Daewoo Securities Research

6. Financial position and risk factors

Doosan Corp.'s financial stability has improved steadily on debt repayment through the disposal of shares, real estate and businesses.

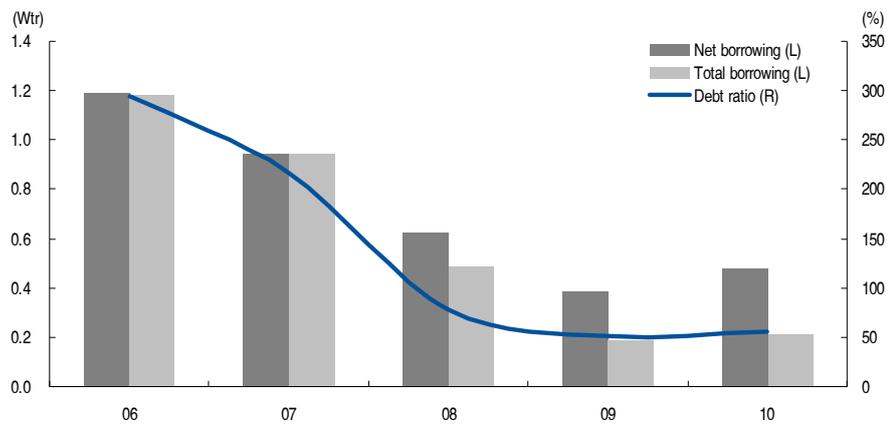
Doosan Corp. to maintain financial stability going forward

The company split off the publishing and packaging divisions in October and December 2008, thereby transferring debts of W103.8bn and W199.2bn, respectively. In addition, Doosan Corp. received W200.8bn for the disposal of the packaging division. Despite a stake acquisition in DIP Holdings (W130bn), an additional stake purchase in Doosan Mottrol Holdings (W21.9bn), and participation in a rights offering for Doosan Infracore (W90bn), Doosan Corp.'s net borrowings dwindled to W260.9bn by end-2009, thanks to gains from the disposal of its liquor business (W503bn).

Net borrowings increased from W260.9bn at end-2009 to W293.2bn in September 2010. However, the company's debt ratio and "ratio of total borrowings and bonds payable to total assets" improved slightly.

Doosan Corp.'s financial flexibility is supported by 1) its valuable stake in Doosan Heavy I&C and 2) its ability to purchase treasury shares. Moreover, Doosan Heavy I&C, an intermediate parent company, significantly reduces Doosan Corp.'s financial risks. Accordingly, we expect Doosan Corp. to maintain financial stability going forward.

Figure 68. Borrowings and debt ratio trend for Doosan Corp.



Source: Daewoo Securities Research

Doosan Corp. (000150 KS/Buy/TP: W180,000)

Income Statement (Summarized)				
(Wbn)	12/10	12/11F	12/12F	12/13F
Sales	1,531	1,969	2,313	2,740
Cost of Goods Sold	1,088	1,168	1,455	1,645
Gross Profit	443	802	858	1,096
SG&A	190	421	440	525
Operating Profit	253	381	418	570
Non-Operating Income	-1	0	0	0
Interest Income/Expense	-13	-14	-14	-14
F/X-Related Gain/Loss	-2	-1	-1	-1
Equity Method Gain/Loss	0	0	0	0
Asset Disposal Gain/Loss	16	17	17	17
Other Non-Operating Profit/Loss	-2	-1	-1	-1
Pretax Profit	252	381	419	570
Tax	29	44	49	66
Profit from Continuing Operation	222	337	370	504
Profit from Discontinued Operation	40	0	0	0
Tax Effect	13	0	0	0
Net Profit	262	337	370	504
Residual Income	262	337	370	504
EBITDA	295	431	461	606
Free Cash Flow	-17	128	160	266
Gross Profit Margin (%)	28.9	40.7	37.1	40.0
EBITDA Margin (%)	19.2	21.9	19.9	22.1
Operating Margin (%)	16.5	19.4	18.1	20.8
Net Margin (%)	17.1	17.1	16.0	18.4

Balance Sheet (Summarized)				
(Wbn)	12/10	12/11F	12/12F	12/13F
Current Assets	745	981	1,261	1,492
Cash and Cash Equivalents	214	289	436	517
Accounts Receivable	284	383	450	533
Inventories	119	160	188	223
Other Current Assets	128	149	186	219
Non-Current Assets	2,442	2,705	2,841	3,195
Investment Assets	1,908	2,219	2,396	2,786
Property, Plant and Equipment	443	411	383	359
Intangible Assets	92	75	61	50
Total Assets	3,188	3,686	4,101	4,687
Current Liabilities	620	746	797	869
Accounts Payable	223	301	353	418
Short-Term Debt	4	4	4	4
Current Long-Term Debt	255	255	221	187
Other Current Liabilities	138	186	218	259
Non-Current Liabilities	523	628	699	788
Bonds	196	196	196	196
Long-Term Debt	25	25	25	25
Other Non-Current Liabilities	302	407	478	567
Total Liabilities	1,143	1,374	1,496	1,656
Paid-In Capital	154	154	154	154
Capital Surplus	750	750	750	750
Retained Earnings	611	879	1,172	1,597
Stockholders' Equity	2,045	2,312	2,605	3,031

Cash Flow (Summarized)				
(Wbn)	12/10	12/11F	12/12F	12/13F
Cash Flow from Operating Activities	95	128	160	266
Net Profit	262	337	370	504
Non-Cash Income and Expense	-141	-166	-181	-204
Tangible Assets Depreciation	30	32	28	24
Intangible Assets Depreciation	12	18	15	12
Others	-183	-216	-224	-240
Chg in Working Capital	-26	-44	-29	-35
Chg in Accounts Receivable	-67	-99	-67	-83
Chg in Inventories	4	-41	-28	-35
Chg in Accounts Payable	70	78	53	65
Others	-33	19	14	18
Cash Flow from Investment Activities	-99	-92	26	-162
Chg in Tangible Assets	-112	17	17	17
Chg in Intangible Assets	-1	-1	-1	-1
Chg in Investment Assets	-6	-115	30	-166
Others	21	6	-20	-12
Cash Flow from Financing Activities	-30	36	-40	-24
Chg in Borrowings	32	105	37	54
Chg in Equity	-62	-70	-77	-79
Dividends	-58	-70	-77	-79
Others	0	0	0	0
Chg in Cash	26	71	146	80
Beginning Cash Balance	189	214	289	436
Ending Cash Balance	215	285	435	516

Forecasts/Valuations (Summarized)				
	12/10	12/11F	12/12F	12/13F
P/E (x)	18.0	11.4	10.4	7.6
P/CF (x)	16.2	10.5	9.7	7.3
P/B (x)	2.4	1.7	1.5	1.3
EV/EBITDA (x)	14.8	8.1	7.2	5.2
EPS (W)	8,536	10,931	11,999	16,344
CFPS (W)	9,496	11,967	12,901	17,129
BPS (W)	63,393	72,527	82,462	96,604
DPS (W)	2,500	3,000	3,000	3,000
Payout Ratio (%)	22.3	23.8	21.7	15.9
Dividend Yield (%)	1.6	2.4	2.4	2.4
Sales Growth (%)	60.6	28.6	17.5	18.5
EBITDA Growth (%)	-	46.4	6.9	31.6
Operating Profit Growth (%)	-	50.8	9.8	36.3
EPS Growth (%)	12.4	28.1	9.8	36.2
Accounts Receivable Turnover (x)	7.3	5.9	5.6	5.6
Inventory Turnover (x)	14.0	14.1	13.3	13.3
Accounts Payable Turnover (x)	9.6	7.5	7.1	7.1
ROA (%)	8.8	9.8	9.5	11.5
ROE (%)	13.6	15.5	15.1	17.9
ROIC (%)	68.4	68.9	58.3	60.7
Liability to Equity Ratio (%)	55.9	59.4	57.4	54.6
Current Ratio (%)	120.2	131.5	158.2	171.7
Net Debt to Equity Ratio (%)	10.4	6.3	-2.1	-5.9
Interest Coverage Ratio (x)	11.1	16.6	18.1	24.7

Source: Company data, Daewoo Securities Research estimates

Hanwha Corp. (000880 KS)

Buy (Initiate)

Target Price (12M, W)	W63,000		
Share Price (06/01/11, W)	46,450		
Expected Return (%)	35.6		
EPS Growth (11F, %)	52.2		
Market EPS Growth (F, %)	26.5		
P/E (11F, x)	8.4		
Market P/E (11F, x)	10.8		
KOSPI (06/01/11, p)	2,141.34		
Market Cap (Wbn)	3,482		
Shares Outstanding (mn)	75		
Avg Trading Volume (60D, '000)	664		
Avg Trading Value (60D, Wbn)	32		
Dividend Yield (11F, %)	1.3		
Free Float (%)	56.1		
52-Week Low	33,200		
52-Week High	57,300		
Beta (12M, Daily Rate of Return)	1.3		
Price Return Volatility (12M Daily, %,SD)	2.4		
Foreign Ownership (%)	18.0		
Major Shareholder(s):			
Kim Seung Yeon et al. (36.04%)			
Treasury shares (7.84%)			
NPS (6.14%)			
Price Performance			
(%)	1M	6M	12M
Absolute	-5.6	2.5	35.2
Relative	-3.3	-8.5	3.9

Slow but steady growth

- Attractive valuation
- Steady growth of Hanwha's own operational activity to increase NAV
- Initiate coverage with a Buy rating and a target price of W63,000

We initiate our coverage of Hanwha Corp. with a Buy call and a target price of W63,000. To calculate the NAV of Hanwha Corp., we employed the sum-of-the-parts valuation methodology to sum 1) the value of the company's operating business units, 2) the value of investment securities (operating assets) in its subsidiaries, and 3) the present value of the company's future brand royalties and rental income, and subtracted its net borrowings.

Our investment recommendation is premised on the following:

1) Undervalued shares

We believe that Hanwha Corp.'s shares are significantly undervalued. Hanwha Corp.'s market cap is W3.6tr, while the value of its investment securities in Hanwha Chemical, Korea Life Insurance, and Hanwha E&C is W4.8tr (134% of the market cap), after the inclusion of a 20% discount to reflect a holding company's income tax obligations.

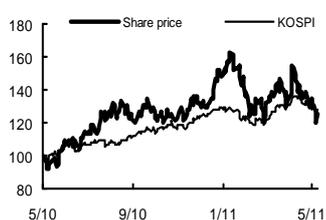
2) Steady growth of manufacturing subsidiaries

Hanwha Corp.'s manufacturing segment (not including the trade division) is anticipated to enjoy strong growth until 2015, with sales, operating profit and net profit increasing 14.1%, 12.8% and 19.9% a year, respectively. In particular, the company's multiple launch rocket systems (a part of the government's guided weapon system), should start generating sales beginning in 2014.

3) Stabilizing financial position

We expect Hanwha Corp.'s weak financial position, which has weighed on the company's shares, to recover quickly. Net borrowings shot up to W2.24tr at one point in 2008, but have since declined to W1.91tr in 2010 thanks to healthy EBITDAs (W270~400bn a year). We expect the company's net borrowings to fall further to W1.7tr in 2013, and W1.25tr in 2015.

Hanwha Corp.'s profitability is improving overall, thanks to its strong operating activities and equity-method gains from its subsidiaries. We expect the company to continue to report solid profitability for the time being.



► Earnings & Valuation Metrics

FY	Sales (Wbn)	OP (Wbn)	OP Margin (%)	NP (Wbn)	EPS (W)	EBITDA (Wbn)	FCF (Wbn)	ROE (%)	P/E (x)	P/B (x)	EV/EBITDA (x)
12/09	4,676	235	5.0	561	7,443	281	295	27.7	6.4	1.6	19.7
12/10	5,231	243	4.7	274	3,638	289	14	10.6	12.8	1.3	18.8
12/11F	5,429	224	4.1	418	5,535	266	69	13.6	8.4	1.1	20.3
12/12F	5,591	247	4.4	447	5,931	285	42	12.9	7.8	1.0	19.4
12/13F	5,919	256	4.3	468	6,206	290	58	12.1	7.5	0.9	19.5

Source: Company data, Daewoo Securities Research estimates

1. Valuation

Present Buy rating with
a TP of W63,000

We initiate coverage of Hanwha Corp. with a Buy call and a target price of W63,000.

Hanwha Corp. does not fall into a holding company category under the Monopoly Regulation and Fair Trade Act (MRFTA). However, the company's investment securities of its subsidiaries and equity-method gains account for a large proportion of its NAV (investment securities represent 75%). Thus, we used the sum-of-the-parts valuation method to calculate the NAV of Hanwha Corp., summing the operating value (manufacturing and trade businesses) and the investment securities value (Korea Life Insurance, Hanwha Chemical and Hanwha E&C) of the company. The NAV of Hanwha Corp.'s manufacture and trade segments was calculated based on its average EV/EBITDA for the past three years. The valuation of listed subsidiaries is based on their market caps, and that of unlisted subsidiaries is based on their book values.

Table 37. Calculation of target price for Doosan Corp. (Wbn)

	Value	Remarks
1. Present values of future income	2,158	
Operating value	2,007	EV/EBITDA: 7.0x
Brand royalty		Terminal growth rate=2%, WACC=11%
Rental income	151	Fair value
2. Investment asset value	5,549	
Listed subsidiaries	4,015	Based on market value
Unlisted subsidiaries	1,534	Based on book value
3. Total asset value (1+2)	7,707	
4. Net borrowings	1,907	End-4Q 2010
5. NAV (3+4)	5,799	
6. No. of shares ('000)	69,558	Outstanding shares
7. NAV per share (W)	83,371	
8. Target price (W)	63,000	Applied discount rate of 20%
Current price (W)	46,450	As of June 1, 2011
Discount rate (%)	44.3	
Upside potential (%)	35.6	

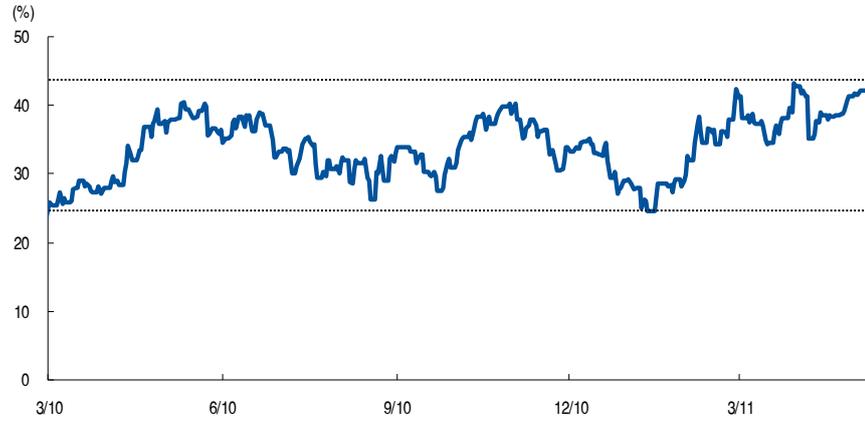
Source: Daewoo Securities Research

Table 38. Estimated value of investment securities (Wbn)

	% of stake	Book value	Current price	Value	Remarks
Listed subsidiaries				4,015	
Korea Life Insurance	21.7%		7,450	1,404	As of June 1, 2011
Hanwha Chemical	37.9%		49,150	2,610	
Unlisted subsidiaries				1,534	
Hanwha Hotel & Resort	50.6%	214		214	Based on book value
Hanwha E&C	100.0%	1,218		1,218	
Hanwha TechM	100.0%	102		102	

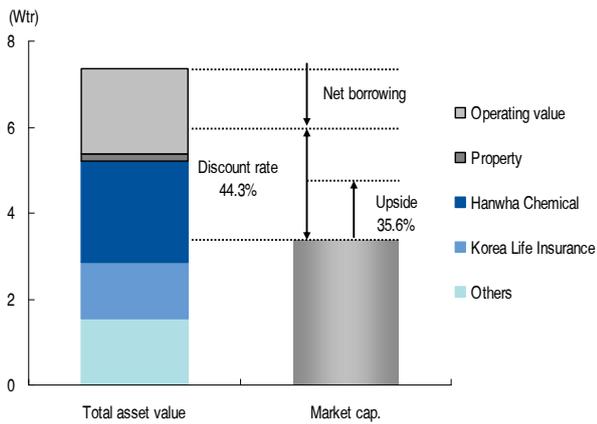
Source: Daewoo Securities Research

Figure 69. NAV discount rate trend for Hanwha Corp.



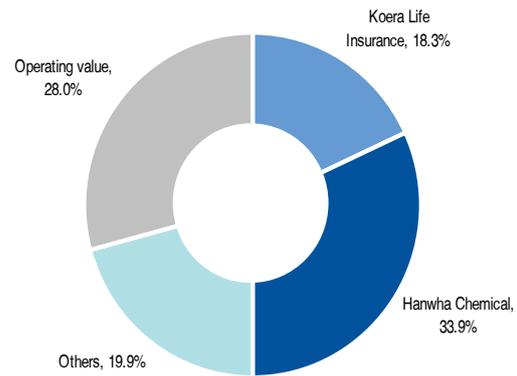
Source: Daewoo Securities Research

Figure 70. Hanwha Corp.'s NAV breakdown



Source: Daewoo Securities Research

Figure 71. Subsidiaries' contribution to Hanwha Corp.'s NAV



Source: Daewoo Securities Research

2. Company overview

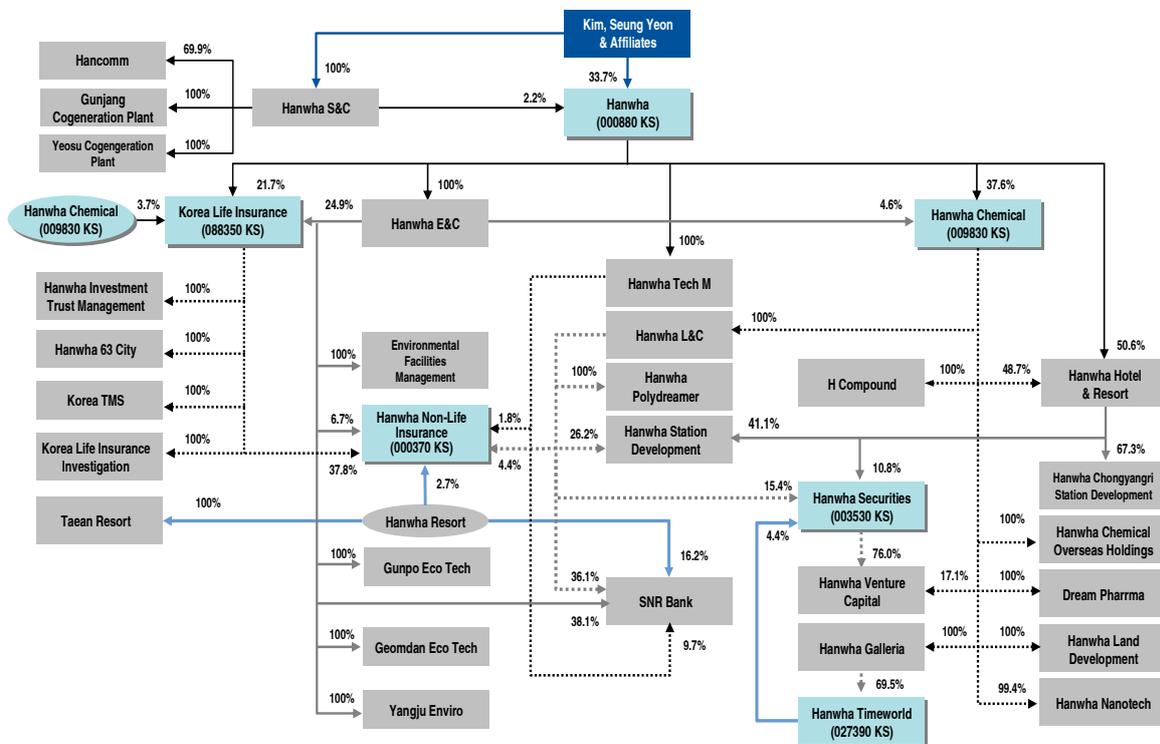
1) Ownership and business areas

Hanwha Group is the 13th largest conglomerate

Hanwha Group is the 13th largest conglomerate in Korea with 52 affiliates. Although Hanwha Corp. is not recognized as a holding company under the MRFTA, it is a de facto holding company of the group which controls major affiliates such as Hanwha Chemical and Hanwha E&C.

Hanwha Corp. (36% owned by CEO Seung-young Kim and affiliated parties) is the largest shareholder of Hanwha Chemical, which owns majority shares of other Hanwha Group affiliates. Thus, Hanwha Corp. has a stable management control of group affiliates.

Figure 72. Hanwha Corp.'s corporate governance



Source: DART, Daewoo Securities Research

Hanwha's earnings are sensitive to changes in domestic consumption

Hanwha Group's businesses are largely divided into four segments: 1) manufacture/construction, 2) finance, 3) service/leisure and 4) others. Since most of the company's businesses are domestic-oriented (except for chemicals), its earnings are sensitive to changes in domestic consumption and business environments, in our view.

Founded in October 1952 as Korea Explosives, the company had been the exclusive manufacturer of explosives in Korea. Since 1995, the company has expanded its business scope to trade (through the acquisition of Golden Bell Trading), pharmaceuticals, construction and telecommunications. Since most of the M&A deals were motivated by an intention to support marginal affiliates (rather than to create synergies between related businesses), the company's operations had little relation among each other. After the construction and machinery divisions were spun off in 2002, and the telecommunications division was sold, the company's businesses were simplified to manufacturing and trade. In 2005, the company sold off 50% of its factory site in Incheon, and is currently operating a land sale business on the remaining lot.

Table 39. Major subsidiaries by business type

Type of business	Listed	Unlisted
Manufacture / Construction (23)	Hanwha Corp. (000880 KS) Hanwha Chemical (009830 KS)	Hanwha L&C, H Compound, Hanwha E&C Hanwha Nanotech, Dream Pharma Hanwha Tech M, Hanwha Polydreamer
Finance (10)	Hanwha Securities (003530 KS) Hanwha Non-life Insurance (000370 KS) Korea Life Insurance (088350 KS)	SNR Bank, Hanwha Investment Trust Management Hanwha Venture Capital, Korea TMS Korea Life Insurance Investigation Prudential Asset management, Prudential Securities
Service and others (19)	Hanwha Timeworld (027390 KS)	Hanwha Galleria, Hanwha S&C Hanwha Hotel & Resort, Hancomm Hanwha 63 City, Hanwha Station Development

Source: Daewoo Securities Research

2) Analysis of Hanwha’s own operational activities

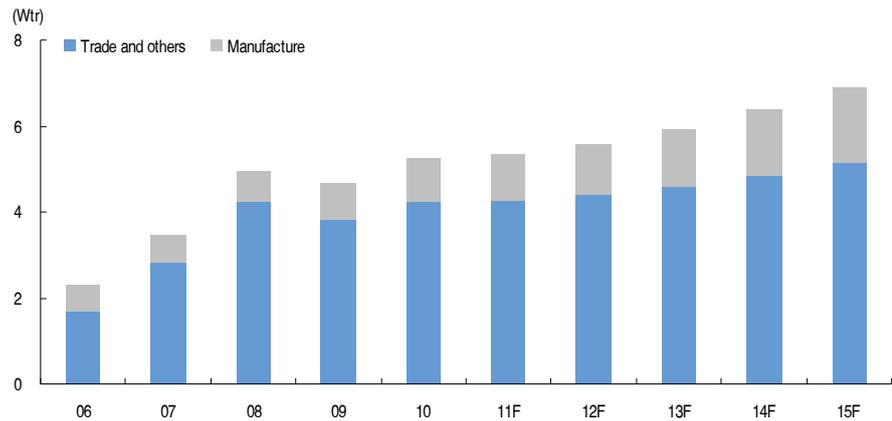
As of 2010, Hanwha Corp.’s manufacture and trade businesses respectively accounted for 20% and 80% of total sales. The disproportionately large portion of trade sales is due to the recognition of Incheon development project-related sales in the trade account since 2006.

Hanwha’s sales expanded 11.9% in 2010 on economic recovery and launches of new explosive products

Hanwha Corp.’s top line has grown sharply over the past couple of years, thanks to the Incheon development project conducted since 2006, and the launches of high value-added explosive products (precision guided weapons) since 2007. Sales contracted in 2009 due to lower ASPs caused by oil price declines, but expanded 11.9% in 2010, thanks to stable oil prices, increased trade sales on economic recovery, launches of new explosive products, and solid demand.

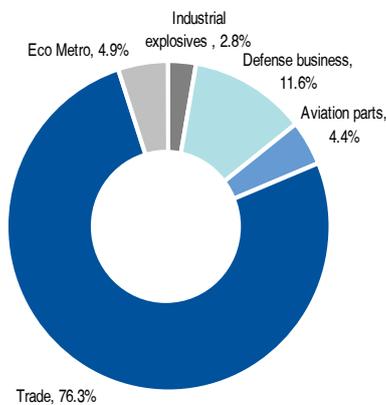
Sales growth should slow going forward, as the contribution of the Incheon development project to sales has been declining since 2010. However, Hanwha Corp. will likely continue to report steady sales growth, thanks to its stable trade business and new product launches at the explosive division.

Figure 73. Hanwha’s annual sales by division



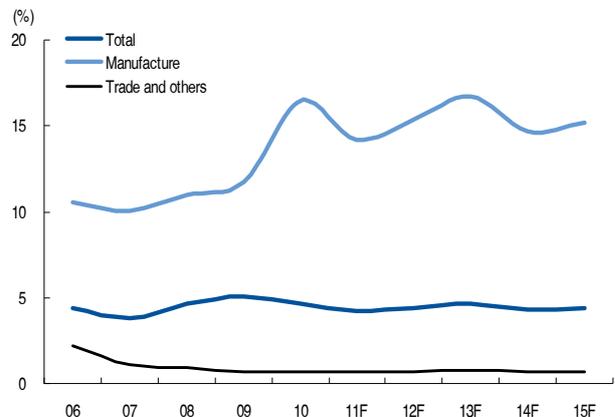
Source: Daewoo Securities Research estimates

Figure 74. Division contribution to Hanwha Corp.’s sales



Note: As of 2010
Source: Company data, Daewoo Securities Research

Figure 75. Operating profit margin trend by division



Source: Daewoo Securities Research estimates

A. Manufacture segment

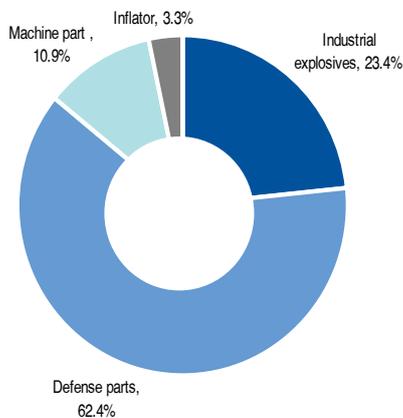
Hanwha has a de facto monopoly on the market

Hanwha Corp. is one of the two major defense companies in Korea, along with Poongsan. However, the company has a de facto monopoly on the market, as each defense company produces different products in accordance with the government’s defense specialization policy. Indeed, Hanwha Corp. is the only Korean defense company with proprietary technologies in rocket propelled projectiles.

Hanwha Corp. is the leading producer of industrial explosives in terms of product line-ups, technology and distribution channels. As industrial explosives are mainly used in construction and mining businesses, sales are sensitive to changes in construction market environments. However, we expect Hanwha Corp.’s industrial explosive sales to grow steadily going forward, at around 2% per year, thanks to its monopolistic position in the market (a 75% market share).

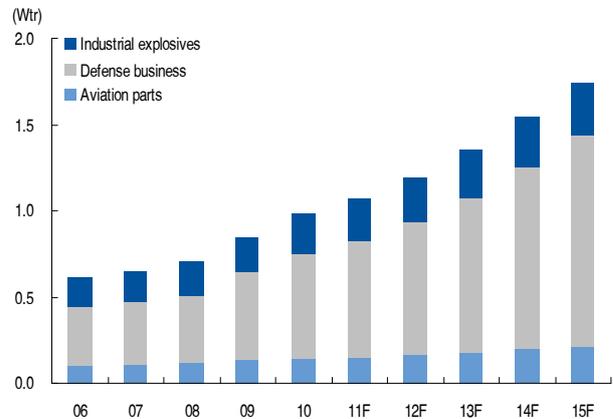
Defense explosive sales are heavily influenced by government policies. However, the defense explosive market has high barriers to entry, and the business stability of Hanwha Corp.’s defense business has strengthened as the company was recently selected as a comprehensive defense company by the Korean government. The company should further benefit from: 1) the government’s efforts to build a state-of-the-art weapon development system, 2) the completion of large-caliber, multiple-launch rocket production plant, 3) the selection as the guided weapon specialization company, and 4) the acquisition of Daewoo Electronics’ plant capable of producing electronically operated fuses.

Figure 76. Sales at the manufacture segment



Source: Daewoo Securities Research

Figure 77. Sales breakdown at the manufacture segment



Note: As of 2010

Source: Company data, Daewoo Securities Research

B. Trade division

The trade division took up 81% of sales at Hanwha Corp. in 2010. The division imports required items and exports items produced by its subsidiaries.

Hanwha's trade division recorded a low growth rate but generated stable earnings

The division's major trade items are petrochemical products. Its sales jumped during 2007~2008 thanks to an increase in petroleum/petrochemical product prices in line with oil price hikes and export growth of chemicals and automobiles. However, sales plunged in 2009 on a slump in demand amid the global economic slowdown and a decline in the prices of major trading items. The downtrend in sales is projected to continue for a considerable period of time as an increasing number of manufacturers are directly sourcing their needs.

Meanwhile, Hanwha Corp. sold half of the land of its former Incheon plant site to Fine Partners for W310bn in May 2005, and has constructed apartments on the remainder of the site. The company presold 2,920 units in November 2006 and 4,226 units in 1H07, achieving a 90% presale rate.

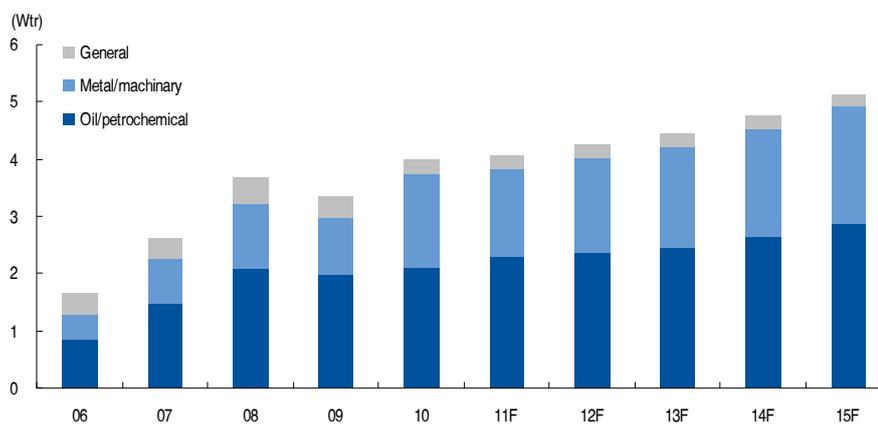
However, presale on the third construction project (fewer units) on the same site launched in 2010 has been lackluster. Thus, operating revenue from land development projects is now on the decline. The project is scheduled to continue until 2014, and earnings from it might fluctuate depending on the conditions of the domestic construction market.

Table 40. Sales and operating profit from the EcoMetro project (Wbn)

	2007	2008	2009	2010	2011~14F
Sales	208.9	555.2	477.7	258.2	562.0
Operating profit	37.1	119.4	113.2	53.3	121.0

Source: Hanwha, Daewoo Securities Research

Figure 78. Trade division's sales and operation profit trends



Source: Daewoo Securities Research

3. Major subsidiaries

1) Hanwha Chemical

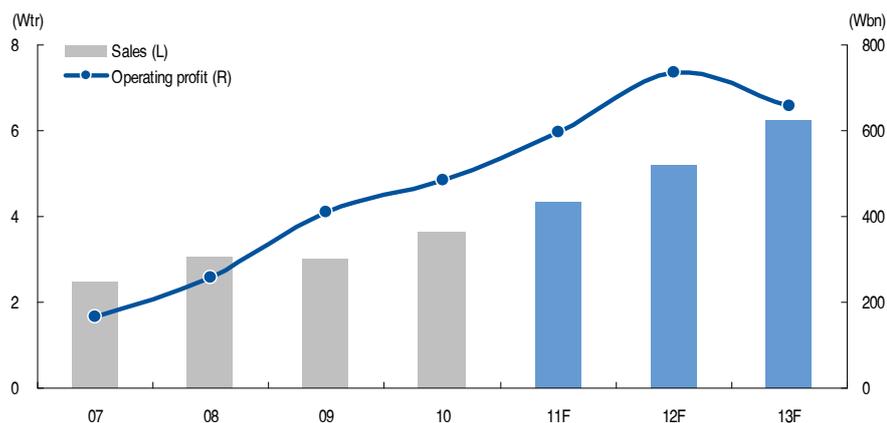
Hanwha Chemical has maintained robust profitability based on strong competitiveness and favorable business environment. OP margin at the PVC and LDPE divisions remain above 10%, and profitability at the CA division has improved sharply in line with the market recovery. As a result, 2010 OP margin reached a healthy 13.4%. In light of supply/demand outlook for major products and improving competitiveness, Hanwha Chemical's profitability is expected to remain robust over the mid term.

Hanwha Chemical's pretax profit projected to jump 50% YoY on strong PVC spread

In 2011, the company's pretax profit is projected to jump 50% YoY on strong PVC spread. The margin of PVC, its flagship product, will likely expand further.

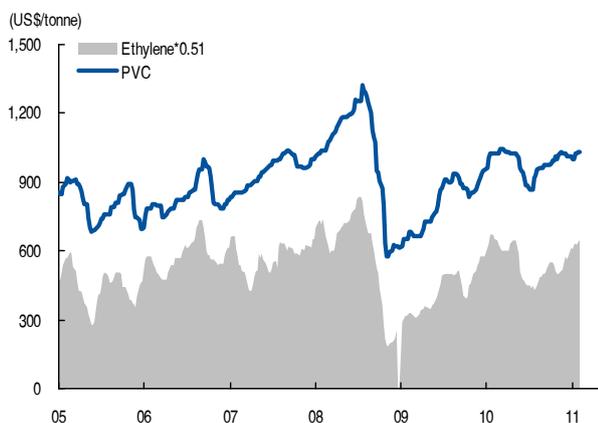
On the supply side, capacity utilization rates at carbide-based product manufacturers in China have declined on raw material (coal and electricity) price hikes. However, demand is projected to surge thanks to public housing construction projects in China and reconstruction efforts in Japan. Despite the recent rise in naphtha prices, PVC margin is forecast to improve further when reconstruction in Japan picks up speed.

Figure 79. Hanwha Chemical's sales and operating profit trends



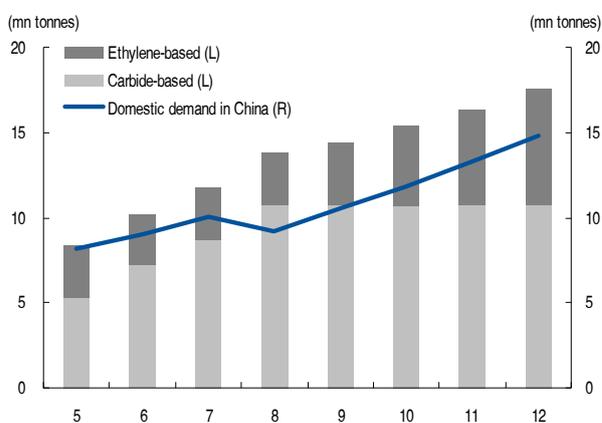
Source: Daewoo Securities Research

Figure 80. PVC price and spread trends



Source: Daewoo Securities Research

Figure 81. Supply and demand for PVC in China



Source: Daewoo Securities Research

2) Hanwha E&C

Hanwha E&C's profitability has fallen on the slowdown of the housing market and decrease in public projects. In 2010, OP margin edged down YoY to 5.4% due to less sales contribution from high-margin Incheon EcoMetro project and larger uncollectible receivables related to the housing business.

However, the company held sufficient order backlogs worth W9tr as of end-2010. The company should be able to maintain stable sales going forward with strong civil engineering orders for public and infrastructure projects, orders from affiliates (namely Hanwha Corp. and Hanwha Chemical), and overseas plant orders.

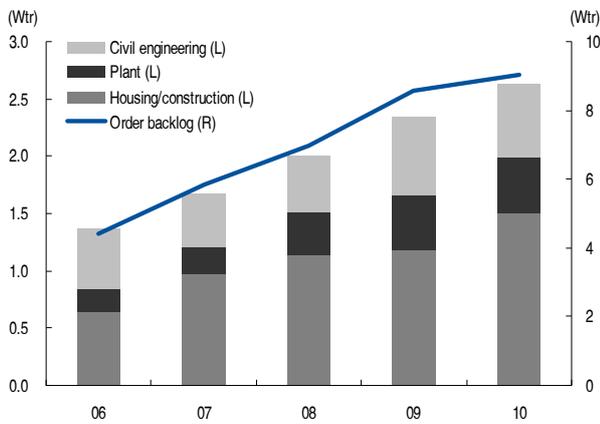
Hanwha E&C's PF liabilities reached W2.12tr

As of end-March 2011, the company's contingent PF liabilities reached W2.12tr. The company has reduced PF debts on projects in progress through gains from housing pre-sales. However, the launch of scheduled projects has been delayed amid the slump in the housing market, expanding its PF debt burden. Accordingly, the company is seeing steady growth of its PF debt balance.

Contingent PF risk unlikely to raise the company's financial risks

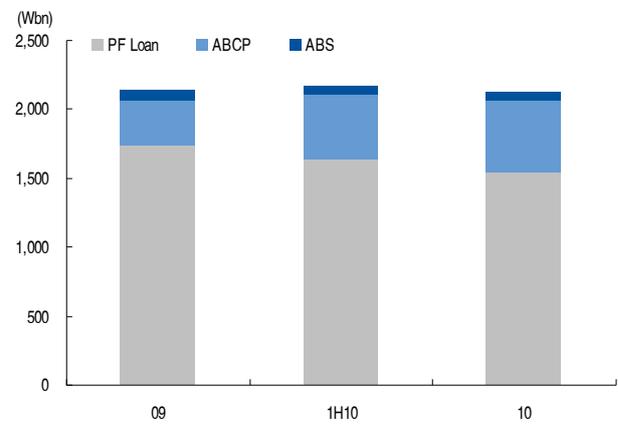
PF debt balance related to scheduled projects accounts for 58% of the company's entire PF debt, and contingent PF debts that mature within one year account for 47.1%. These factors are weighing on the company's financials. However, presale rates in the Cheongna and Byeollae sites are relatively high and the company continues to repay its debts on schedule. Thus, contingent PF debts are unlikely to raise the company's financial risks.

Figure 82. Hanwha E&C's sales and order backlog trends



Source: Company data, Daewoo Securities Research

Figure 83. Hanwha E&C's PF debt balance trend



Source: Company data, Daewoo Securities Research

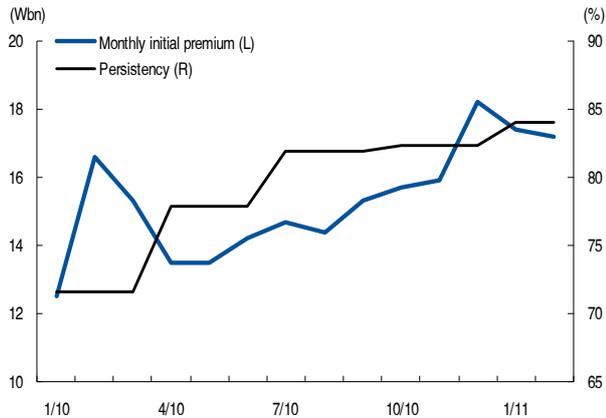
3) Korea Life Insurance

The quality of Korea Life Insurance's product portfolio is improving

The quality of Korea Life Insurance's product portfolio is improving on 1) steady sales growth of variable rate insurance products and 2) maturing of high-interest savings-type insurance policies sold in FY07. As such, the percentage of guaranteed interest insurance products out of its total insurance contracts declined to 43.0% in 1HFY10 (vs 57.7% in FY06), while the percentage of the reserves for the high guaranteed interest products (8% or higher) fell to 4.2% (vs. 6.1% FY06), reducing the burden of negative profit margin. In addition, the ratio of claims paid to premium income steadily dropped to 65.7% in 1HFY10 after shooting up to 80.7% in FY08, backed by stricter underwriting and more thorough review of payment of claims. Meanwhile, the ratio of incurred loss to risk premium also improved, positively affecting profitability.

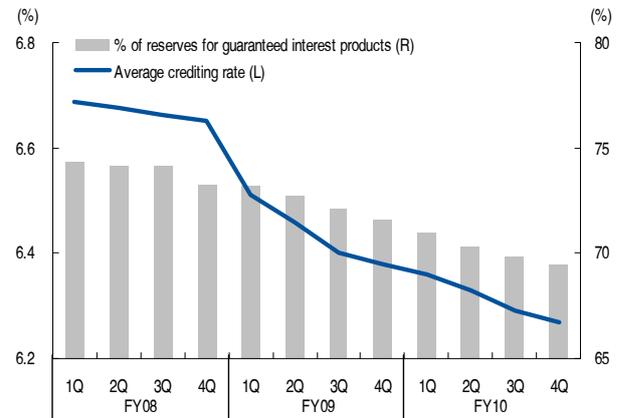
In FY08, the company recorded a sharp decline in net profit, as its surrender ratio rose due to the global financial crisis while posting a W175bn loss arising from the impairment of foreign-currency-denominated beneficiary certificates. However, the company posted stable interest income after the financial crisis, and earnings at its investment division normalized thanks to a profit of W134bn in 1HFY10 from securities trading (vs. W176bn in FY09). As such, the company posted a massive net profit of W303bn in 1HFY10 (vs. W418bn in FY09).

Figure 84. Korea Life Insurance's monthly initial premium and persistency rate



Source: Daewoo Securities Research

Figure 85. Average crediting rate and % of reserves for guaranteed interest products



Source: Daewoo Securities Research

4) New growth engine: Solar power generation business

Hanwha Group achieved vertical integration of its solar power generation business

Hanwha Group is seeking to expand its solar power generation business. Although the solar power generation market is growing rapidly in line with rising oil prices and greater use of renewable energy sources, the market is highly volatile as it is currently in the early stage of the industry life cycle. Hanwha Group achieved vertical integration of its solar power generation business (ranging from polysilicon to ingot/wafer to solar cells/modules to power generation) through aggressive M&As in less than a year.

Hanwha Chemical acquired a 49.99% stake in a Chinese ingot/wafer/module maker for W430bn and renamed it Hanwha SolarOne in August 2010. Hanwha SolarOne produces a 400MW ingot/wafer and plans to expand its solar cell and module capacities from 500MW and 900MW to W1.3GW and 1.5GW, respectively, by year end. The company also plans to invest US\$1bn in the Nan Tong economic development zone of China to build a 2GW solar cell/module plant. This investment will be a two-stage project, with the first stage scheduled to be completed in end-2010.

Hanwha Corp. established Hanwha Solar Energy in early May 2011. The solar power generation company is pursuing business partnerships with North American and European players and plans to build 1GW or more solar power generation capacity at home and abroad by 2015, targeting annual solar power generation of more than 100MW by 2015. The company already signed a strategic partnership with Solar Monkey specializing in solar power plants in January 2011.

Furthermore, Hanwha Chemical's BOD decided to invest W1tr in building a polysilicon plant with annual capacity of W10,000 tonnes on May 11th. Hanwha Chemical plans to embark on the construction of the plant in early 2012 and start its operation in 2H13, targeting to generate annual sales of around W500 from 2014. The in-house production of polysilicon, the core material for solar cells, will allow the company to secure not only stable material supply but also price competitiveness.

4. Investment points

1) Undervalued considering investment assets

Undervalued considering investment assets

We believe that shares of Hanwha Corp. are undervalued. Hanwha Corp.'s market cap stands at around W3.6tr, while the value of its investment securities, including those in Hanwha Chemical, Korea Life Insurance, and Hanwha E&C, is W4.8tr (after the inclusion of a 20% discount to reflect a holding company's income tax obligations), which is about 134% of its market cap.

Hanwha E&C, a wholly owned subsidiary of Hanwha Corp., has posed a PF-guarantee-related risk, as Sambu filed for a court receivership (Hanwha Corp. provided a PF guarantee of W550bn for Sambu's construction project in Gimpo). However, Hanwha E&C is unlikely to face a liquidity crunch in light of its operating cash flow (W170~245bn) and investment securities (W1.87tr).

2) Manufacturing business to steadily grow

Next-generation multiple rocket launcher to contribute to sales from 2014

Hanwha Corp.'s manufacturing segment is expected to post annual average sales growth of 14.1% and operating profit growth of 12.8% by 2015, while net profit is projected to rise at a CAGR of 19.9%. We should note that the company is anticipated to complete the development of a next-generation multiple rocket launcher by 2013 as part of the government's efforts to introduce a guided artillery system. This is expected to contribute to sales from 2014.

Although Hanwha Corp.'s trade segment contributes up to 75% of the company's sales, its contribution to earnings is very low. However, this is likely to change, as the contribution from the E&P business to sales of the trade segment will likely increase.

3) Financial risks to gradually ease

Shares were weighed down by the company's excessive borrowings

Shares of Hanwha Corp., which have been weighed down by the company's excessive borrowings, should start to improve as net borrowings have steadily fallen since reaching W2.24tr in 2008, thanks to an annual EBITDA of W270~400bn. We forecast net borrowings to continue to gradually drop from W1.91tr in 2010 to W1.7tr in 2013 and W1.25tr in 2015.

5. Earnings forecasts

Hanwha Corp.'s major revenue source likely to display gradual profitability improvement

The manufacturing segment, Hanwha Corp.'s major revenue source, has displayed gradual profitability improvement over the past several years. We expect new products being developed by the manufacturing segment, including guided weapons, to solidly drive the company's future earnings.

The trade segment maintains a stable business, as it serves as an import/export channel for Hanwha affiliates' petrochemical products. However, we expect the segment's contributions to earnings to remain low due to 1) slowing sales growth amid a delay in the global economic recovery and 2) low profitability.

Pretax profit has increased markedly to more than twice operating profit since 2009, backed by higher equity-method gains from robust earnings at Hanwha Chemical and Korea Life Insurance. We expect pretax profit to remain strong for the time being in light of Hanwha Corp.'s solid operating activities and earnings at subsidiaries.

Table 41. Equity-method gains by major subsidiary (Wbn, %)

Subsidiaries	% of stake	Equity -method gains				Percentage			
		2007	2008	2009	2010	2007	2008	2009	2010
Hanwha Chemical	34.8%	102.5	39.2	155.1	147.6	39.8	23.5	32.5	69.5
Korea Life Insurance	33.5%	65.8	53.0	95.1	98.8	25.5	31.7	19.9	46.5
Hanwha Hotel & Resort	30.6%	10.4	4.3	10.0	-17.8	4.0	2.5	2.1	-8.4
Hanwha E&C	33.5%	61.9	59.0	211.1	-26.7	24.0	35.3	44.3	-12.6
Hanwha TechM	34.0%	15.3	1.2	-4.1	11.4	5.9	0.7	-0.9	5.3
Others	-	1.9	10.2	9.5	-1.0	0.7	6.1	2.0	-0.5

Source: Daewoo Securities Research

Table 42. Quarterly earnings forecast for Hanwha Corp. (Wbn, %)

	2010					2011F					FY11 1Q growth	
	1Q	2Q	3Q	4Q	Annual	1QF	2QF	3QF	4QF	Annual	QoQ	YoY
Sales	1,232.1	1,230.7	1,244.3	1,523.9	5,231.0	1,129.7	1,344.3	1,314.0	1,593.8	5,381.8	-25.9	-8.3
Manufacturing	216.7	205.1	203.3	356.6	981.7	212.3	217.2	220.2	418.8	1,068.6	-40.5	-2.0
Trade	949.1	943.3	962.0	1,136.8	3,991.1	864.6	1,062.2	1,038.8	1,145.2	4,110.8	-23.9	-8.9
Eco Metro	66.4	82.2	79.0	30.5	258.2	52.8	64.9	54.9	29.7	202.4	73.0	-20.4
Operating profit	53.6	78.1	55.8	55.7	243.2	49.7	68.9	57.9	46.9	223.5	-10.7	-7.3
Manufacturing	33.4	42.3	38.7	47.0	161.4	32.5	39.0	41.3	38.5	151.4	-30.8	-2.8
Trade	10.0	11.0	3.0	4.5	28.5	5.9	12.5	7.2	2.1	27.8	31.2	-40.3
Eco Metro	10.2	24.8	14.2	4.1	53.3	11.3	17.4	9.4	6.3	44.4	172.2	10.2
OP Margin	4.4	6.3	4.5	3.7	4.6	4.4	5.1	4.4	2.9	4.2	0.7	0.1
Manufacturing	15.4	20.6	19.0	13.2	16.4	15.3	18.0	18.7	9.2	14.2	2.1	-0.1
Trade	1.0	1.2	0.3	0.4	0.7	0.7	1.2	0.7	0.2	0.7	0.3	-0.4
Eco Metro	15.4	30.1	17.9	13.6	20.6	21.3	26.8	17.2	21.1	21.9	7.8	5.9

Source: Daewoo Securities Research

6. Financial and risk analysis

Free cash flow to be limited in the mid-term despite solid operating cash flow

Hanwha Corp.'s capital expenditure rose YoY due to capacity expansion related to a new line of explosive products in 2010. Going forward, capital expenditure is expected to increase sharply in the mid term as a result of 1) capacity expansion for the production of explosives, 2) relocation of an explosives R&D center, and 3) an increase in E&P investments at the trade division. Therefore, free cash flow will be limited in the mid term despite solid operating cash flow, in our view.

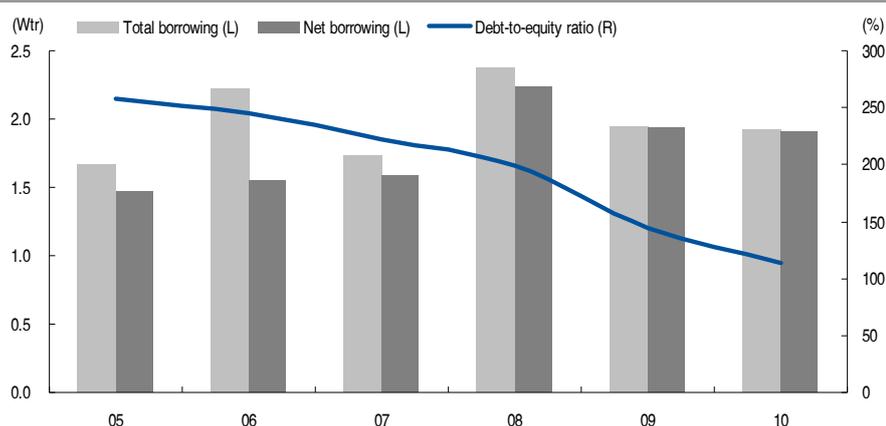
Hanwha Corp. participated in Hanwha E&C's rights offering in November 2007 (W300bn), Hanwha Chemical's rights offering in June 2008 (W106.2bn), and acquired a stake in Korea Life Insurance in September 2008 (W166.6bn). In addition, the company also purchased stakes in Hanwha TechM and Hanwha Hotels & Resorts in 2009. These spending may undermine the company's overall cash flow and financial stability in the future.

The company's debt-to-equity and debt-to-asset ratios have steadily improved despite a rise in borrowings since mid-2000, as higher earnings and equity-method gains have expanded equity capital. As of end-September 2010, the company's debt-to-equity and debt-to-asset ratios stood at stable levels of 112.2% and 32.9%, respectively.

Going forward, Hanwha Corp. is likely to continue to provide financial assistance to its subsidiaries and affiliates, including collateral/payment guarantees, investments in the establishment of new affiliates, purchase of affiliates' shares, and participation in affiliates' rights offerings.

However, we believe that Hanwha Corp.'s group risks have been significantly fallen on the back of 1) improving financials at its affiliates and 2) earnings growth at chemical subsidiaries, including Hanwha Chemical.

Figure 86. Hanwha Corp.'s borrowings and debt-to-equity ratio



Source: Daewoo Securities Research

Hanwha Corp. (0008800 KS/Buy/TP: W63,000)

Income Statement (Summarized)				
(Wbn)	12/10	12/11F	12/12F	12/13F
Sales	5,231	5,429	5,591	5,919
Cost of Goods Sold	4,758	4,921	5,076	5,370
Gross Profit	473	508	515	549
SG&A	230	284	268	293
Operating Profit	243	224	247	256
Non-Operating Income	55	264	276	291
Interest Income/Expense	-102	-101	-101	-101
F/X-Related Gain/Loss	-10	19	23	23
Equity Method Gain/Loss	212	412	441	455
Asset Disposal Gain/Loss	0	0	0	0
Other Non-Operating Profit/Loss	-46	-67	-87	-87
Pretax Profit	299	488	523	547
Tax	24	70	75	79
Profit from Continuing Operation	274	418	447	468
Profit from Discontinued Operation	0	0	0	0
Tax Effect	0	0	0	0
Net Profit	274	418	447	468
Residual Income	274	418	447	468
EBITDA	289	266	285	290
Free Cash Flow	14	69	42	58
Gross Profit Margin (%)	9.1	9.4	9.2	9.3
EBITDA Margin (%)	5.5	4.9	5.1	4.9
Operating Margin (%)	4.7	4.1	4.4	4.3
Net Margin (%)	5.3	7.7	8.0	7.9

Balance Sheet (Summarized)				
(Wbn)	12/10	12/11F	12/12F	12/13F
Current Assets	1,478	1,791	1,845	1,953
Cash and Cash Equivalents	7	9	10	10
Accounts Receivable	710	859	885	937
Inventories	596	722	743	787
Other Current Assets	164	201	207	219
Non-Current Assets	4,684	5,033	5,563	6,111
Investment Assets	4,133	4,528	5,099	5,684
Property, Plant and Equipment	489	453	421	392
Intangible Assets	61	52	43	36
Total Assets	6,161	6,824	7,408	8,064
Current Liabilities	2,201	2,390	2,553	2,749
Accounts Payable	602	728	750	794
Short-Term Debt	810	810	810	810
Current Long-Term Debt	490	490	620	750
Other Current Liabilities	299	362	373	395
Non-Current Liabilities	1,082	1,179	1,196	1,229
Bonds	519	519	519	519
Long-Term Debt	102	102	102	102
Other Non-Current Liabilities	462	559	575	609
Total Liabilities	3,283	3,569	3,749	3,978
Paid-In Capital	377	377	377	377
Capital Surplus	594	594	594	594
Retained Earnings	1,801	2,177	2,583	3,009
Stockholders' Equity	2,878	3,254	3,660	4,086

Cash Flow (Summarized)				
(Wbn)	12/10	12/11F	12/12F	12/13F
Cash Flow from Operating Activities	77	69	42	58
Net Profit	274	418	447	468
Non-Cash Income and Expense	-72	-195	-352	-334
Tangible Assets Depreciation	38	36	32	29
Intangible Assets Depreciation	8	7	6	5
Others	-118	-238	-390	-368
Chg in Working Capital	-125	-154	-54	-76
Chg in Accounts Receivable	-49	-181	-59	-87
Chg in Inventories	-12	-125	-22	-44
Chg in Accounts Payable	56	127	22	44
Others	-121	27	5	10
Cash Flow from Investment Activities	-4	-42	-44	-77
Chg in Tangible Assets	-62	0	0	0
Chg in Intangible Assets	-15	3	3	3
Chg in Investment Assets	68	-153	-172	-206
Others	5	107	125	125
Cash Flow from Financing Activities	-70	-34	2	19
Chg in Borrowings	-31	97	147	164
Chg in Equity	-42	-42	-42	-42
Dividends	-42	-42	-42	-42
Others	2	-89	-103	-103
Chg in Cash	2	-7	0	0
Beginning Cash Balance	5	7	9	10
Ending Cash Balance	7	0	9	10

Forecasts/Valuations (Summarized)				
	12/10	12/11F	12/12F	12/13F
P/E (x)	12.8	8.4	7.8	7.5
P/CF (x)	11.3	7.7	7.3	7.0
P/B (x)	1.3	1.1	1.0	0.9
EV/EBITDA (x)	18.8	20.3	19.4	19.5
EPS (W)	3,638	5,535	5,931	6,206
CFPS (W)	4,138	6,009	6,361	6,597
BPS (W)	37,341	42,449	47,940	53,696
DPS (W)	600	600	600	600
Payout Ratio (%)	15.2	10.0	9.3	8.9
Dividend Yield (%)	1.3	1.3	1.3	1.3
Sales Growth (%)	11.9	3.8	3.0	5.9
EBITDA Growth (%)	2.8	-7.7	7.0	1.8
Operating Profit Growth (%)	3.5	-8.0	10.3	3.7
EPS Growth (%)	-51.1	52.2	7.2	4.6
Accounts Receivable Turnover (x)	7.6	6.9	6.4	6.5
Inventory Turnover (x)	8.8	8.2	7.6	7.7
Accounts Payable Turnover (x)	9.1	8.2	7.6	7.7
ROA (%)	4.7	6.4	6.3	6.1
ROE (%)	10.6	13.6	12.9	12.1
ROIC (%)	24.6	20.8	15.4	11.4
Liability to Equity Ratio (%)	114.1	109.7	102.4	97.4
Current Ratio (%)	67.1	74.9	72.3	71.1
Net Debt to Equity Ratio (%)	66.3	58.5	55.6	52.9
Interest Coverage Ratio (x)	2.3	2.2	2.4	2.5

Source: Company data, Daewoo Securities Research estimates

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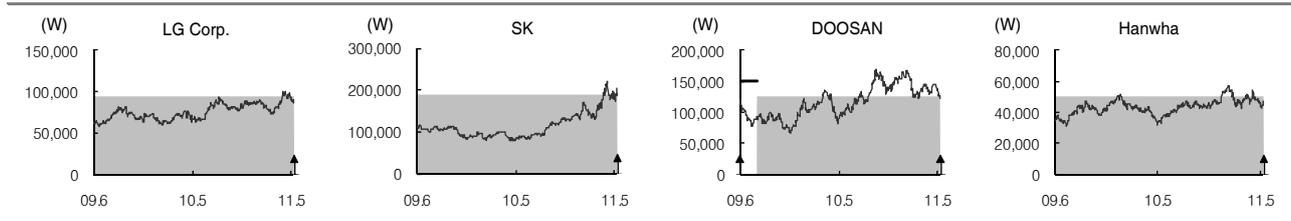
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