

Kolon Industries

(120110 KS)

Stability plus growth

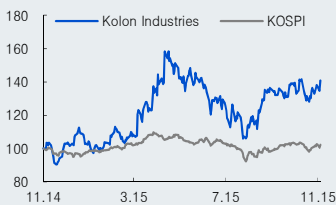
Chemicals

Initiation Report
December 2, 2015

(Initiate)	Buy
Target Price (12M, W)	82,000
Share Price (12/01/15, W)	65,800
Expected Return	25%

OP (15F, Wbn)	299
Consensus OP (15F, Wbn)	297
EPS Growth (15F, %)	-
Market EPS Growth (15F, %)	22.6
P/E (15F, x)	-
Market P/E (15F, x)	11.4
KOSPI	2,023.93
Market Cap (Wbn)	1,653
Shares Outstanding (mn)	28
Free Float (%)	61.3
Foreign Ownership (%)	16.8
Beta (12M)	1.09
52-Week Low	42,250
52-Week High	73,900

(%)	1M	6M	12M
Absolute	6.0	1.1	41.1
Relative	6.2	5.0	37.0



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A diversified chemicals company

Kolon Industries is a diversified chemicals company engaged in the industrial materials, chemicals, films/electronic materials, and fashion businesses. The company has a number of products that lead the global ranks, such as tire cords, airbags, and hydrocarbon resins. The films/electronic materials unit produces PET films for a variety of applications as well as nylon films, while the fashion unit owns a diversified brand portfolio that includes the flagship brand Kolon Sport.

Margin gains in industrial materials/chemicals and rise of new brands in fashion

1) We expect tire cord supply/demand to continue to improve. Massive capacity expansions in 2011-12 led to increased supply, but demand proved weaker than anticipated, resulting in a supply glut. However, the exit of rival Toyobo from the tire cord business and a pickup in tire demand have helped reduce excess capacity, and as a result, supply/demand conditions have been improving since 2014. With no meaningful capacity ramp-ups on the horizon, we expect tire cord earnings to continue to grow.

2) We believe hydrocarbon resins will serve as the company's cash cow, supporting the earnings stability of the chemicals unit. Chemicals earnings have remained robust, underpinned by hydrocarbon volume growth following capacity ramp-ups and an improving product mix. Given growing demand and high product prices (despite the recent fall in raw material prices), we anticipate the chemicals unit to generate double-digit margins.

3) We expect new designer brands and entry into China to drive the growth of the fashion business. The fashion unit has diversified its brand portfolio to accessories and women's designer brands, and has launched several major brands in China, which should offset the impact of the slowing domestic outdoor clothing market. We believe the rapid growth of new brands (Couronne, Suecomma Bonnie, and Lucky Chouette) and China operations should be watched closely.

Initiate coverage with Buy and TP of W82,000

We initiate our coverage on Kolon Industries with a Buy rating and target price of W82,000. We derived our target price using a sum-of-the-parts methodology based on 2016 estimates. The stock is currently trading at a 2016F P/E of 7.6x and P/B of 0.9x.

Kolon Industries' shares have performed poorly due to the aramid lawsuit with DuPont and the weakness of the films/electronic materials business. However, the company reached a settlement with DuPont in May 2015, which should allow business to get back on track. It will likely take some time for the film market to recover, but we believe further downside risks to earnings are limited and already priced in. At current share prices, the company looks undervalued relative to its competitors. We expect valuation to normalize on the back of robust earnings resulting from the stable growth of major industrial materials products and an improving chemicals mix.

FY (Dec.)	12/12	12/13	12/14	12/15F	12/16F	12/17F
Revenue (Wbn)	5,313	5,261	5,338	4,896	5,026	5,107
OP (Wbn)	294	232	169	299	340	352
OP margin (%)	5.5	4.4	3.2	6.1	6.8	6.9
NP (Wbn)	167	112	42	-117	242	261
EPS (W)	6,010	4,008	1,517	-4,195	8,674	9,362
ROE (%)	9.6	6.2	2.3	-6.3	12.5	12.0
P/E (x)	10.6	13.6	31.9	-	7.6	7.0
P/B (x)	0.9	0.8	0.7	1.0	0.9	0.8

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

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I. Investment points

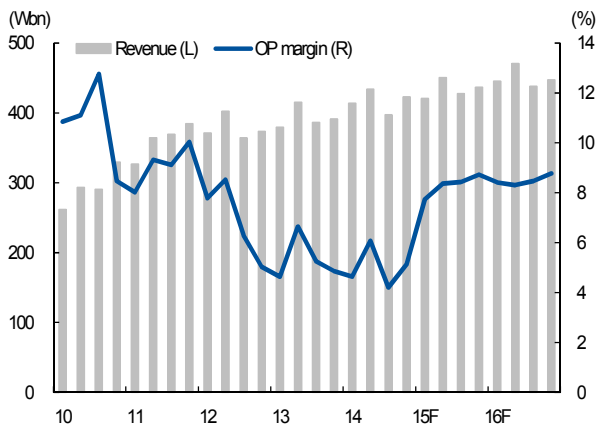
1. Industrial materials: Tire cord earnings to improve on easing of oversupply

For tire cords, we expect supply and demand conditions to improve going forward, as the increased supply stemming from past large-scale capacity ramp-ups appears to be being digested.

In 2009, tire cord supply became tight as demand grew in line with the recovery of the downstream market. To meet demand, Kolon Industries and Hyosung expanded their capacities by 15,000 and 20,000 tonnes, respectively, in 2011-12. Afterwards, however, demand proved weaker than expected, leading to a supply glut.

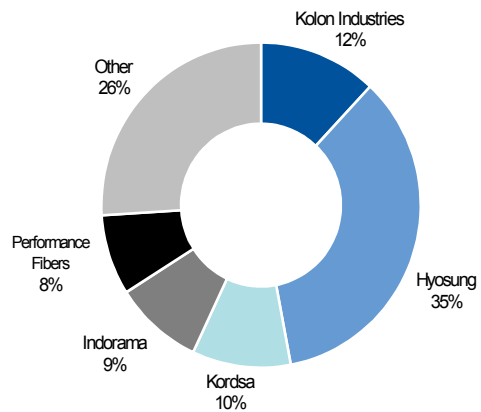
Market conditions turned more favorable last year, due to 1) the exit of global rival Toyoba from the tire cord business in 2013, and 2) a pickup in tire demand. We have not seen any meaningful capacity ramp-up since 2013, other than Kordsa's launch of a new plant in Indonesia earlier this year. Amid muted supply growth, tire cord producers' earnings are expected to improve going forward. Indeed, despite sluggish downstream demand and the downtrend in raw material prices, contract prices remain robust.

Figure 1. Industrial materials earnings



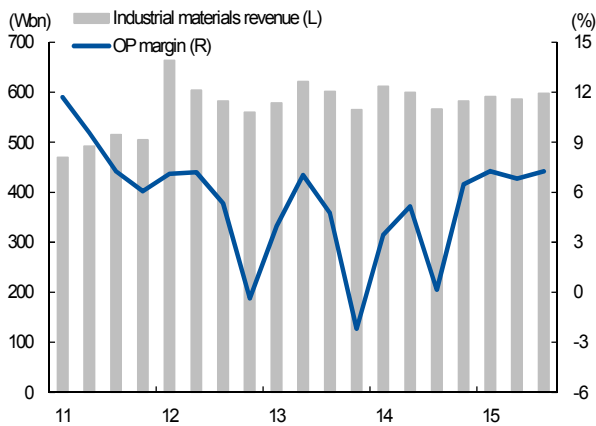
Source: KDB Daewoo Securities Research

Figure 2. PET tire cord market share (2014)



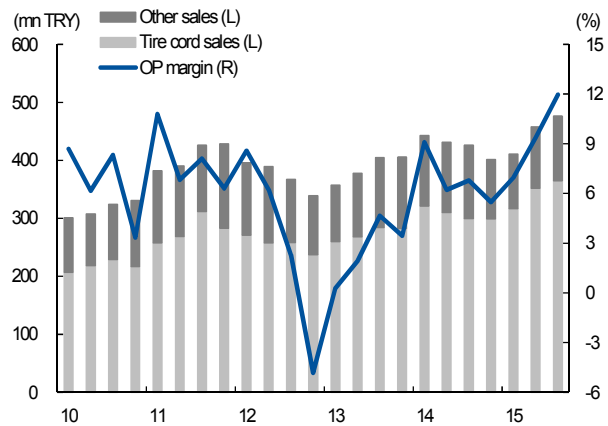
Source: ADL, Kordsa, KDB Daewoo Securities Research

Figure 3. Hyosung's industrial materials earnings



Source: Dart, KDB Daewoo Securities Research

Figure 4. Kordsa's earnings



Source: Bloomberg, KDB Daewoo Securities Research

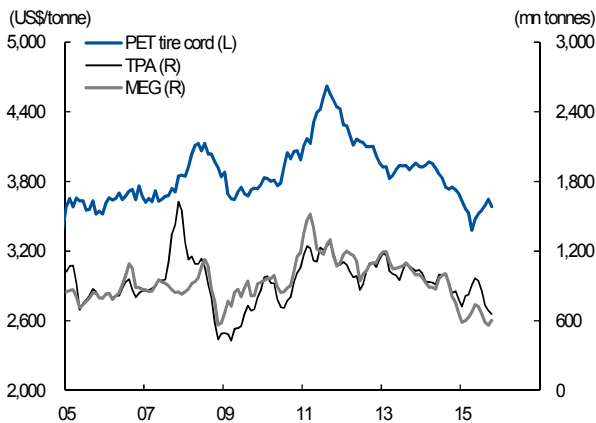
Additional capacity ramp-ups should be limited. As it typically takes 1.5 to two years to bring newly added facilities online after completion, supply is unlikely to pick up sharply in the short term. Although cheaper Chinese products could become a substitute, they would be unlikely to meet the high safety standards of global tire makers.

Not just Kolon Industries, but also other top global tire cord makers (Hyosung and Kordsa) are seeing earnings improvements. Kordsa generated 75% of its revenue from tire cords in 1H15, and earnings have picked up steadily this year even after stripping away favorable F/X effects. When releasing its 2Q results, the company left its 2015 revenue growth target (set early this year) unchanged at 10-20%.

Looking ahead, Kolon Industries should be able to obtain new customers, as its years-long lawsuit with DuPont finally came to an end early this year. The aramid lawsuit had restricted Kolon Industries from attracting new customers for various products (including tire cords) in several regions, including North America.

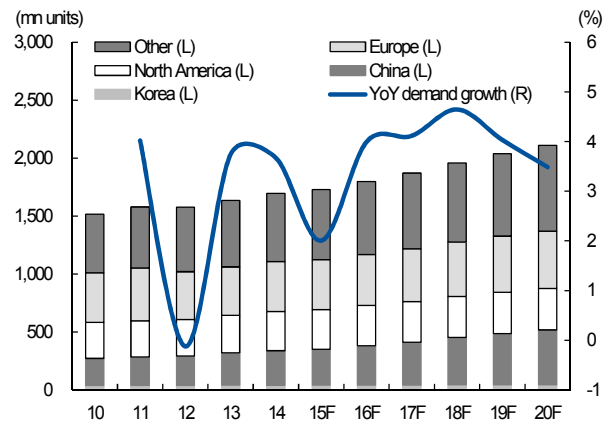
Tire cord demand is unlikely to contract sharply going forward. Although the tire market has yet to recover fully, sales have been robust in North America and Europe, and China's car sales are also picking up. Once tire demand returns to normal levels, tire cord demand should also increase.

Figure 5. Tire cord export price and raw material prices



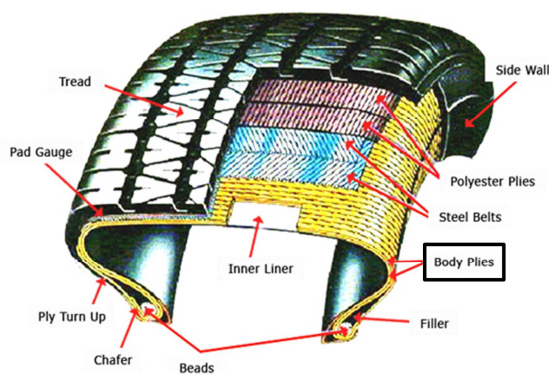
Source: KITA, Cischem, KDB Daewoo Securities Research

Figure 6. Tire demand outlook



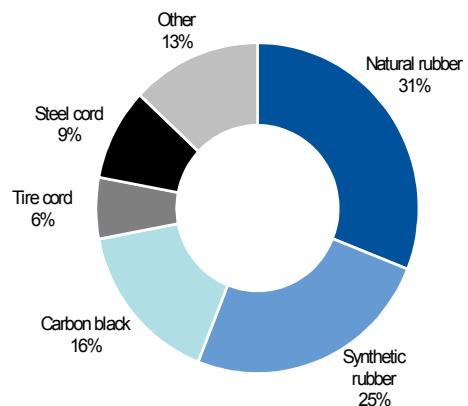
Source: LMC World Tire Forecast, KDB Daewoo Securities Research

Figure 7. Tire cord



Source: Industry data, KDB Daewoo Securities Research

Figure 8. Tire cost breakdown: Tire cords account for only 6% of total costs



Source: Industry data, KDB Daewoo Securities Research

2. Chemicals: Hydrocarbon resins to serve as cash cow, supporting earnings stability

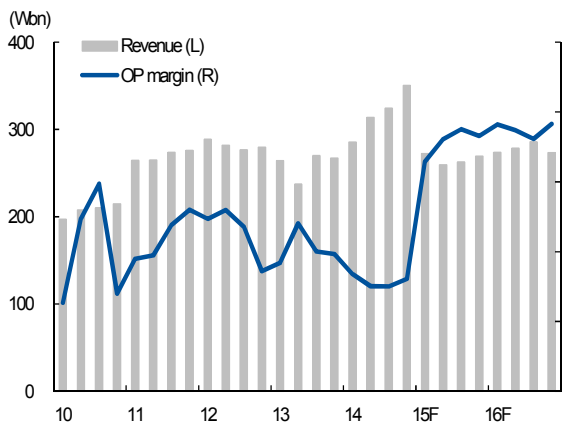
We believe hydrocarbon resins (for use in adhesive tape and paint) will serve as the company's cash cow, supporting the earnings stability of the chemicals unit. The hydrocarbon resin market has an oligopolistic structure; Kolon Industries is the only producer in Korea, while four players (including Kolon Industries, ExxonMobil, and Eastman) dominate 75% of the global market. Thus, product prices are staying solid despite the fall in feedstock prices, leading to high margins.

It is particularly difficult for new players to enter the high-value-added hydrogenated resin segment, which requires specialized production technologies to create a colorless and odorless resin; only top-tier firms (four to five firms) are capable of this. Existing firms have an edge over new entrants (including Chinese firms) in terms of technology and cost competitiveness. In 2014, Kolon Industries ramped up its hydrogenated resin capacity by 30,000 tonnes, and the added capacity is now in full operation. The company's ASP is also very high thanks to growing sales and improving product mix.

For paint (a major downstream product), the cost of hydrocarbon resin accounts for only 5% of overall feedstock expenses. As such, even though feedstock prices are falling due to weak oil prices, there is relatively little downward pricing pressure on hydrocarbon resins. Indeed, chemicals earnings have shown double-digit growth this year, underpinned by falling feedstock prices and capacity ramp-ups.

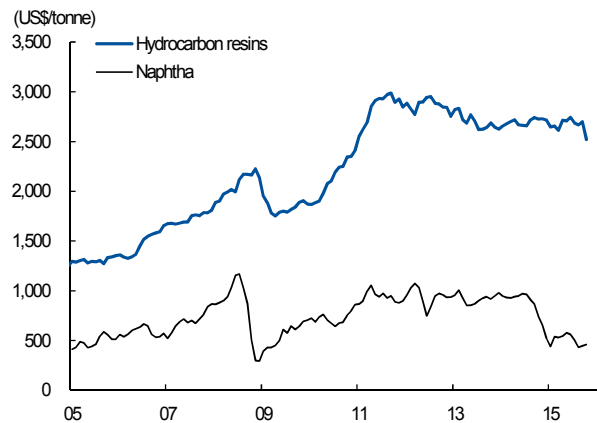
We expect the company's chemicals earnings to stay robust over the next several years, supported by solid demand (amid the growing hygiene product market) and the absence of meaningful supply growth.

Figure 9. Chemicals earnings



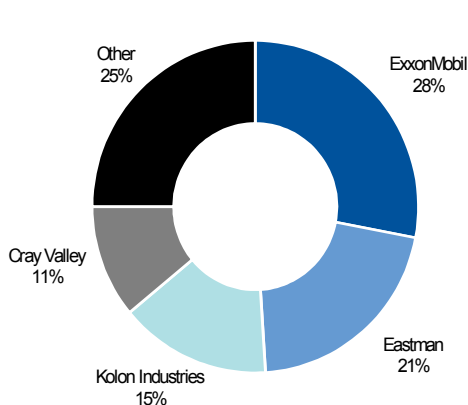
Source: KDB Daewoo Securities Research

Figure 10. Hydrocarbon resin export prices



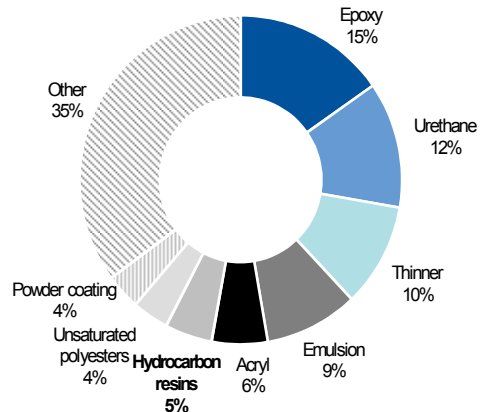
Source: KITA, KDB Daewoo Securities Research

Figure 11. Hydrocarbon resins global market share



Source: Industry data, KDB Daewoo Securities Research

Figure 12. Cost breakdown of paint (a major downstream product of hydrocarbon resins)



Source: KPIC, KDB Daewoo Securities Research

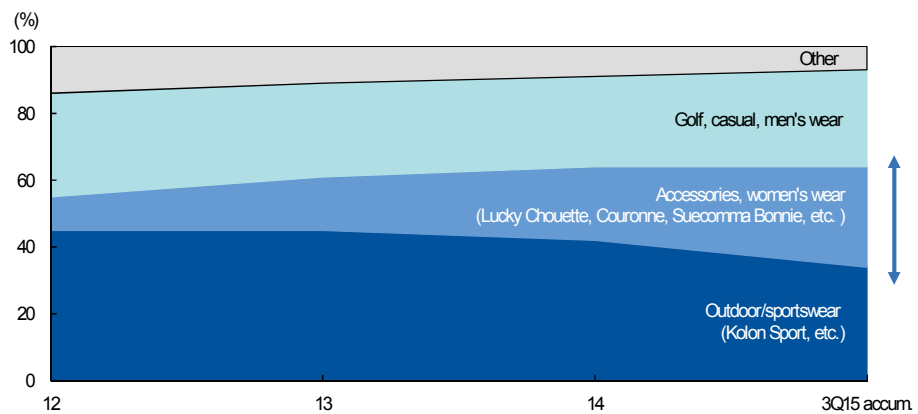
3. Fashion: Focus shifting to designer brands and Chinese market

Growth in the domestic outdoor wear segment is slowing down, leading to stronger price competition. As such, concerns about earnings at the fashion unit, which focuses on the outdoor wear brand Kolon Sport, have increased. However, the unit is expected to maintain robust earnings, as the growth of new designer brands and the entry of some brands into China will likely offset slowing outdoor wear sales.

The designer brands acquired by Kolon Industries are displaying steep growth. Revenue at the bag and accessory brand Couronne grew five-fold from W12bn in 2011 to W62 in 2014. The brand is also anticipated to record strong revenue growth of over 20% in 2015. The Suecomma Bonnie (shoes) and Lucky Chouette (women’s wear) brands have also grown sharply, contributing to the fashion unit’s portfolio diversification.

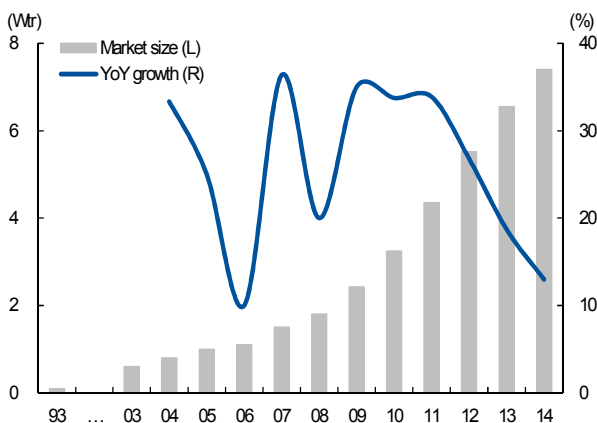
Of note, despite the slowing growth of the domestic apparel market, the accessory market is expanding steadily. In 2014, the entire domestic fashion market grew 4.4%, but the accessory market’s growth exceeded 10%. Accessory sales are climbing steadily in line with fashion brands’ portfolio diversification and the increasing trend of rational consumption. In addition, the heightened image of domestic designer brands is also spurring the accessory market’s growth.

Figure 13. Fashion division sales breakdown by product category



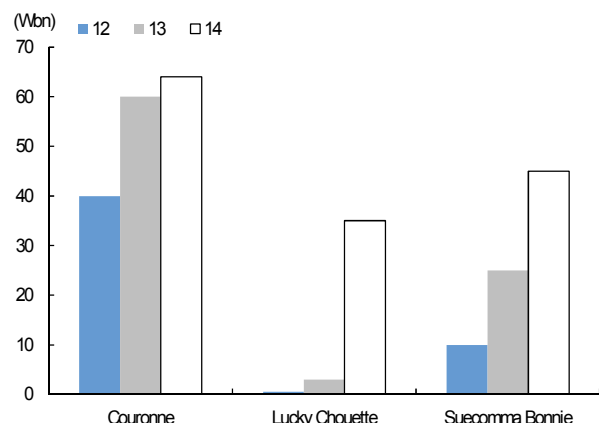
Source: Company data, KDB Daewoo Securities Research

Figure 14. Domestic outdoor apparel market is slowing



Source: Samsung Fashion Institute, KDB Daewoo Securities Research

Figure 15. Designer brands are growing rapidly



Source: Media data, KDB Daewoo Securities Research

Kolon Industries’ major brands are accelerating their outreach into the Chinese market. Suecomma Bonnie opened stores in major department stores in Beijing and Shanghai in September this year, after signing an exclusive distribution contract with Harson Group in August. Kolon Industries aims to boost the brand’s Chinese sales from W16bn in 2016 to W100bn in 2019.

Couronne also knocked on the door of the Chinese market in 2013, but its launch has been delayed due to trademark rights issues. Kolon Industries will likely push forward with the brand’s Chinese launch once these issues are resolved.

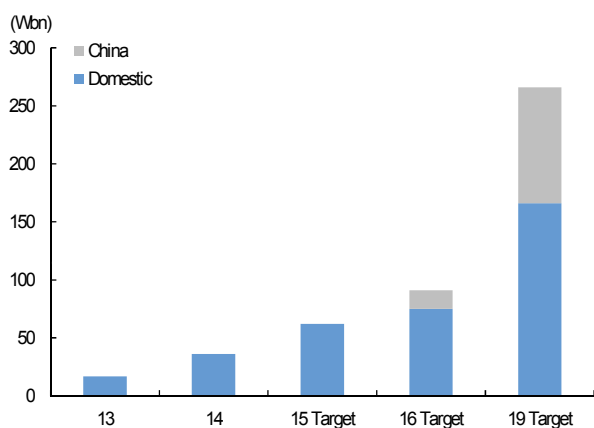
Kolon Sport’s Chinese subsidiary increased the number of stores to 210 (vs. 266 in Korea) in 2015, with a revenue target of W65bn this year. The subsidiary is still suffering from losses due to aggressive store expansion and marketing activities in the early stages of market entry. However, it recorded revenue growth of 130% YoY in 1H15 and is anticipated to swing to a profit next year. We are bullish on the subsidiary in light of the strong double-digit growth of the Chinese outdoor wear market.

Table 1. Global outdoor apparel market share by country (2013): China remains in an early stage

		2013	2015F	2017F
Market size (US\$bn)	Global	18.1	19.4	20.8
	US	2.8	2.9	3.1
	EU	6.6	7.0	7.5
	China	1.0	1.2	1.3
	Other	7.7	8.3	8.9
Market share (%)	Global	100.0	100.0	100.0
	US	15.5	14.9	14.9
	EU	36.5	36.1	36.1
	China	5.5	6.2	6.3
	Other	42.5	42.8	42.8

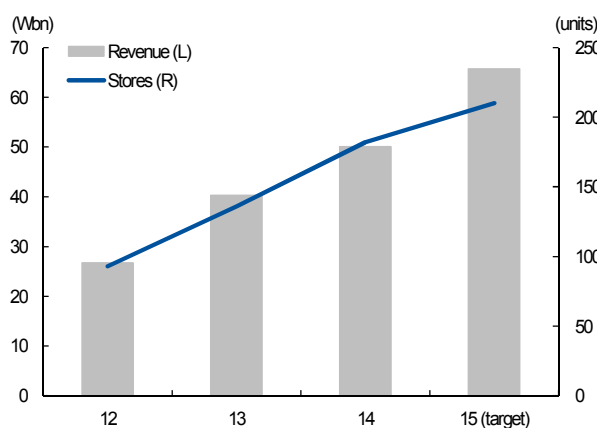
Source: Korea Institute for Knit Industry, KDB Daewoo Securities Research

Figure 16. Suecomma Bonnie sales



Source: Company data, KDB Daewoo Securities Research

Figure 17. Kolon Sport China sales and stores



Source: Company data, KDB Daewoo Securities Research

II. Earnings outlook

Margin improvement and steady growth of major businesses

We project Kolon Industries' 4Q15 operating profit at W91.1bn (+55.2% YoY) in line with the consensus. Industrial materials and fashion earnings are expected to be robust thanks to favorable seasonality. Of note, major industrial materials products, including tire cords and airbags, are anticipated to push up earnings on the back of seasonal demand growth in downstream industries and favorable raw material prices. Chemicals earnings are also forecast to be solid thanks to stable spreads after petrochemical resin capacity expansion. And thanks to the settlement of the legal battle with DuPont, losses at clothing materials and other businesses will likely decline sharply.

We project Kolon Industries' operating profit at W299.3bn (+77.2% YoY) in 2015 and W340.1bn (+13.6% YoY) in 2016. Industrial materials earnings are anticipated to remain healthy, as supply and demand conditions are improving and raw material prices remain stable. In addition, the chemicals unit will likely continue to serve as a cash cow for the company on the back of petrochemical resin capacity ramp-ups and product-mix improvement. The fashion unit should enjoy growth driven by brands launched in China.

In addition, the settlement with DuPont is expected to boost earnings over both the short and long term, as Kolon Industries should no longer incur lawsuit-related expenses (which had been about W40bn annually). The company's restitution payment was reflected in 1Q15 and the booking of attorneys' fees appears to have been almost completed in 3Q. The settlement should also dispel financial uncertainties, boosting the company's credit ratings and, eventually, bringing down interest expenses.

The legal settlement is also normalizing the company's aramid business. After the end of lawsuit, Kolon Industries' aramid sales picked up, turning to black in July. Currently, Kolon Industries' aramid capacity utilization stands at 95%. In addition, the company should be able to resume its efforts to expand its customer base. Over the long term, the dissipation of external issues should help the company pursue sustained growth via investments and capacity expansion. Going forward, we advise investors to pay attention to Kolon Industries' investments in new growth engines.

Table 2. Quarterly and annual earnings forecast

(Wbn, %)

		1Q14	2Q14	3Q14	4Q14	1Q15	2Q15	3Q15	4Q15F	2014	2015F	2016F
Revenue	Total	1,313	1,360	1,244	1,420	1,201	1,235	1,148	1,313	5,338	4,897	5,026
	Industrial materials	414	434	398	423	421	451	428	437	1,669	1,736	1,802
	Chemicals	286	314	324	350	272	260	263	269	1,274	1,064	1,111
	Films/EM	163	160	151	141	129	125	127	116	615	496	496
	Fashion	298	302	247	401	277	276	230	392	1,249	1,175	1,191
	Other	152	151	124	105	102	123	101	100	531	426	426
Operating profit	Total	50	50	10	59	70	76	62	91	169	299	340
	Industrial materials	19	26	17	22	33	38	36	38	84	144	153
	Chemicals	21	22	23	25	29	29	30	30	91	119	128
	Films/EM	5	2	-6	-9	1	-2	1	-1	-7	-1	4
	Fashion	15	18	-5	35	13	15	1	30	63	59	64
	Other	-11	-19	-18	-15	-6	-4	-6	-7	-62	-22	-9
OP margin	Total	3.8	3.7	0.8	4.1	5.8	6.2	5.4	6.9	3.2	6.1	6.8
	Industrial materials	4.6	6.1	4.2	5.1	7.7	8.4	8.4	8.7	5.0	8.3	8.5
	Chemicals	7.4	7.0	7.0	7.2	10.6	11.2	11.5	11.3	7.1	11.1	11.5
	Films/EM	3.2	1.3	-3.9	-6.0	0.4	-1.8	0.6	-0.5	-1.2	-0.3	0.9
	Fashion	5.0	6.0	-2.1	8.7	4.8	5.6	0.4	7.6	5.0	5.1	5.4
	Other	-6.9	-12.4	-14.6	-13.9	-5.4	-2.9	-5.8	-6.7	-11.6	-5.1	-2.1
Pretax profit		50	32	1	19	-299	69	46	77	103	-108	302
Net profit		34	21	-18	6	-243	31	34	61	42	-117	239

Source: KDB Daewoo Securities Research

III. Valuation

Initiate coverage with Buy and TP of W82,000

We initiate our coverage on Kolon Industries with a Buy rating and target price of W82,000. We derived our target price using a sum-of-the-parts methodology based on 2016 estimates. Applying industry average valuations to the chemicals and industrial materials units seems undemanding, as: 1) the chemicals unit has been delivering robust earnings; and 2) sales of flagship industrial materials products, including tire cords, are growing steadily. We applied 30% and 10% discounts against peers to the valuations of the films/electronic materials and fashion units, respectively.

Kolon Industries' shares, which had weakened again after picking up following the settlement with DuPont in May, have been rebounding recently, trading at a 2016F P/E of 7.6x and P/B of 0.9x. At current share prices, the company looks undervalued relative to its competitors, as earnings should remain solid across all business units, excluding films/electronic materials.

The company is currently in the process of medium- to long-term business normalization (aramid business normalization, capacity expansion for airbags and hydrocarbon resins, and film business restructuring). Once production at new facilities stabilizes, the company will likely make new investments to find an additional growth driver, boosting corporate value.

Table 3. Valuation (2016F)

(Wbn, x, number of shares, W)

		Value
EBITDA	Total	549
	Industrial materials	208
	Chemicals	198
	Films/EM	69
	Fashion	74
EV/EBITDA	Total	7.0
	Industrial materials	7.5
	Chemicals	7.5
	Films/EM	5.0
	Fashion	6.0
Operating value (A)	Total	3,833
	Industrial materials	1,560
	Chemicals	1,483
	Films/EM	347
	Fashion	443
Investment asset value (B)		187
Enterprise value (C=A+B)		4,021
Net borrowing (D)		1,882
Fair market cap. (E=C-D)		2,138
Preferred shares market cap. (F)		71
Common shares market cap. (G=E-F)		2,068
Number of common shares (H)		25,103,976
Target price (G/H)		82,372

Source: KDB Daewoo Securities Research

Table 4. Global peer earnings consensus

(Wbn, %)

	Revenue			Operating profit			OP margin			Net profit		
	14	15F	16F	14	15F	16F	14	15F	16F	14	15F	16F
Kolon Industries	5,338	4,987	5,221	169	299	344	3.2	6.0	6.6	42	-112	248
Hyosung	12,177	12,498	13,172	600	1,038	1,177	4.9	8.3	8.9	269	349	541
Toray	19,463	20,675	21,625	1,195	1,459	1,595	6.1	7.1	7.4	687	859	953
Toyobo	3,400	3,402	3,495	199	224	244	5.9	6.6	7.0	79	114	130
Teijin	7,610	7,571	7,353	378	554	554	5.0	7.3	7.5	-78	329	331
DuPont	36,575	31,887	29,823	4,261	4,445	4,763	11.6	13.9	16.0	3,818	2,892	3,276
SKC	2,802	2,596	2,679	152	229	243	5.4	8.8	9.1	69	253	149
Toray	19,463	20,675	21,625	1,195	1,459	1,595	6.1	7.1	7.4	687	859	953
Teijin	7,610	7,571	7,353	378	554	554	5.0	7.3	7.5	-78	329	331
Nitto Denko	7,988	7,977	8,313	1,033	1,150	1,218	12.9	14.4	14.6	754	850	898
LF	1,460	1,582	1,667	96	92	99	6.6	5.8	6.0	81	70	79
Hansome	525	606	705	46	64	82	8.7	10.6	11.6	38	69	67
Fila Korea	797	832	873	94	89	98	11.7	10.7	11.2	59	-78	85
Youngone	1,246	1,573	1,983	186	202	257	14.9	12.8	13.0	128	132	160
Basic House	550	613	656	28	14	41	5.1	2.3	6.3	21	15	32

Source: Bloomberg, KDB Daewoo Securities Research

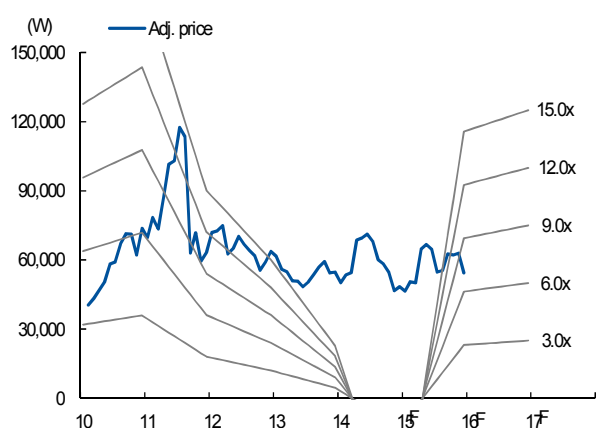
Table 5. Global peer valuation

(x, %)

	EV/EBITDA			P/E			P/B			ROE		
	14	15F	16F	14	15F	16F	14	15F	16F	14	15F	16F
Kolon Industries	8.6	7.3	6.7	29.1	-	6.9	0.6	1.0	0.9	2.2	-6.1	13.0
Hyosung	8.7	8.3	7.7	8.5	12.0	7.8	0.8	1.5	1.2	10.0	11.8	16.3
Toray	10.8	10.2	9.6	22.7	20.0	17.9	1.6	1.7	1.6	7.7	9.0	9.2
Toyobo	8.9	8.0	7.7	17.7	13.6	11.9	0.9	1.0	0.9	5.4	7.4	8.0
Teijin	8.0	6.9	6.9	-	12.7	12.5	1.4	1.4	1.3	-2.8	11.7	10.8
DuPont	12.5	12.6	12.2	19.3	24.2	20.5	5.1	5.7	6.0	24.9	22.7	29.4
SKC	9.3	8.3	8.1	13.8	5.1	8.8	0.8	0.9	0.9	5.8	19.0	10.1
Toray	10.8	10.2	9.6	22.7	20.0	17.9	1.6	1.7	1.6	7.7	9.0	9.2
Teijin	8.0	6.9	6.9	-	12.7	12.5	1.4	1.4	1.3	-2.8	11.7	10.8
Nitto Denko	7.4	7.4	7.1	17.0	15.7	14.9	2.2	2.1	1.9	13.7	14.2	13.3
LF	4.9	5.6	5.3	10.7	12.8	11.7	0.9	0.8	0.8	8.6	7.2	7.7
Hansome	12.5	9.8	8.2	19.0	13.4	13.7	0.9	1.1	1.0	5.0	8.5	7.7
Fila Korea	13.5	13.6	12.3	19.6	-	12.8	2.1	2.1	1.8	11.0	-11.4	15.1
Youngone	10.3	8.5	6.9	18.3	14.6	12.1	2.4	1.8	1.6	14.0	13.1	13.8
Basic House	5.8	4.9	3.4	14.8	15.7	7.4	1.2	0.9	0.8	8.8	2.4	10.6

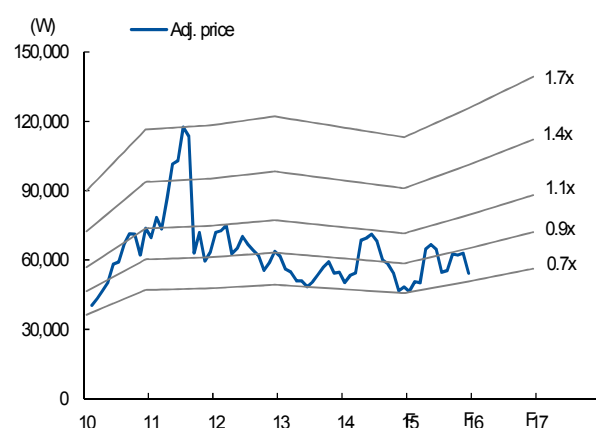
Source: Bloomberg, KDB Daewoo Securities Research

Figure 18. P/E band



Source: KDB Daewoo Securities Research

Figure 19. P/B band



Source: KDB Daewoo Securities Research

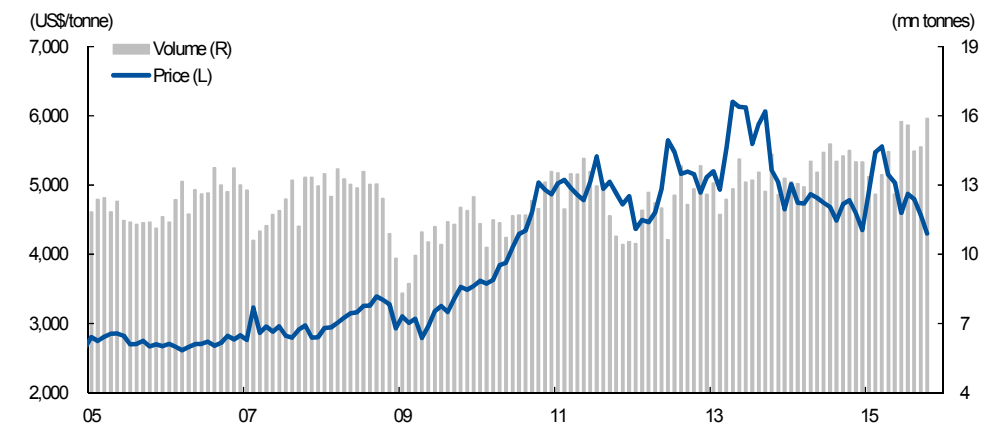
IV. Risks

Unfavorable films/electronic materials market conditions already priced in

At the films/electronic materials unit, profitability remains weak due to the inflow of low-priced products amid oversupply stemming from downstream sluggishness. Competition in optical films, in particular, has intensified on the slowdown in the downstream display market. In addition, margins on commodity film products are steadily weakening due to low-priced imports. PET film makers are also seeing profitability fall on fierce competition. However, these unfavorable market conditions are nothing new and appear to have already been priced in.

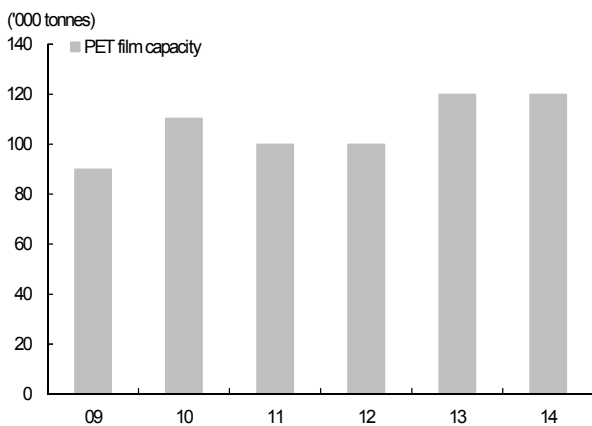
Although PET film makers are currently closing idle facilities and making efforts to drive up production efficiency, it will likely take some time for oversupply arising from capacity additions to ease. In early 2015, DuPont Teijin Films decided to shut down a 30,000-tonne facility. Kolon Industries is also currently trying to reduce fixed costs by closing old/idle facilities and adjusting inventories. Although the market slowdown should persist for the time being, earnings are unlikely to deteriorate further in light of the company's ongoing efforts to raise production efficiency.

Figure 20. PET film prices



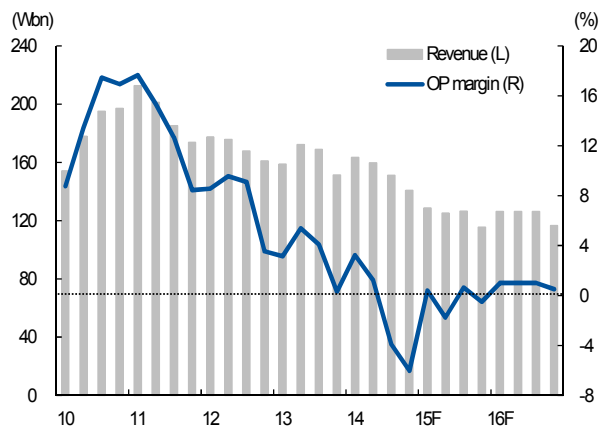
Source: KITA, KDB Daewoo Securities Research

Figure 21. Kolon Industries' film capacity



Source: KOPA, KDB Daewoo Securities Research

Figure 22. Films/electronic materials division earnings



Source: KDB Daewoo Securities Research

V. Company overview

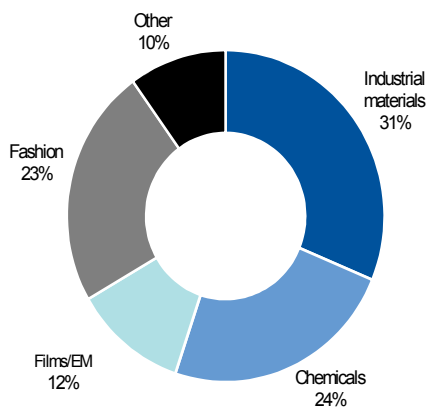
A diversified chemicals company

Kolon Industries was incorporated in 1957 under the name Korea Nylon. With the Kolon group’s conversion to a holding company structure on December 31st, 2009, the manufacturing division was spun off and renamed Kolon Industries. Its businesses are broken down into industrial materials, chemicals, films/electronic materials, and fashion.

1) Industrial materials

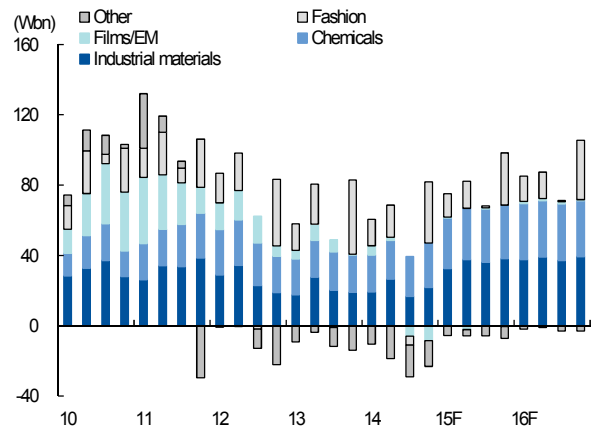
In 2014, industrial materials contributed 31% of revenue and 50% of operating profit. The product portfolio consists of tire cords, airbag cushions (used in airbag modules) and fabrics, car seat materials, and aramid fibers. Airbag cushions and fabrics account for around 25% of industrial materials revenue, and are supplied to leading global airbag module makers Autoliv and Hyundai Mobis. (Takata, which recently was embroiled in a defective airbag scandal, is not one of Kolon Industries’ customers.) Currently, more than 95% of airbags are made with highly durable nylons; Kolon Industries produces nylon as well as polyester airbag products. (Polyester products are similar in performance to nylon products, but cheaper.)

Figure 23. Sales breakdown (2014)



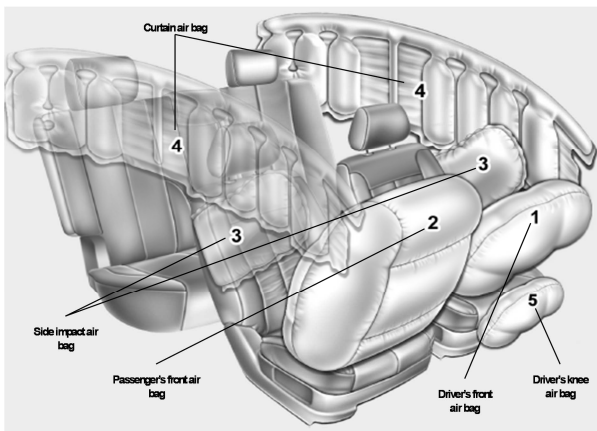
Source: KDB Daewoo Securities Research

Figure 24. Operating profit trends by division



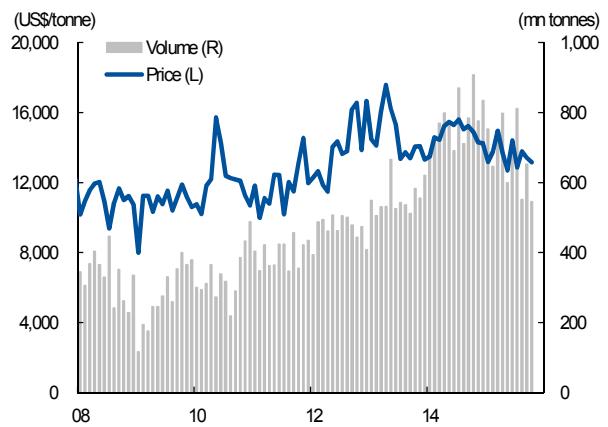
Source: KDB Daewoo Securities Research

Figure 25. Airbag types



Source: Hyundai Motor, KDB Daewoo Securities Research

Figure 26. Airbag cushion export prices and volume



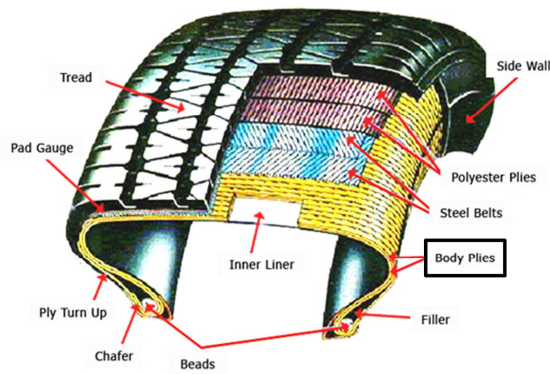
Source: KITA, KDB Daewoo Securities Research

Tire cords are fabrics, usually polyester or nylon, used as reinforcement materials for tires, maintaining tire dimensions and providing comfort and support. Kolon Industries generates around 20% of its revenue from tire cords. Rivals include Hyosung, Kordsa, and Performance Fibers.

As for aramid fibers, Kolon Industries started commercial production in 2005. Aramid fibers are a class of strong, lightweight, heat-resistant reinforcement fibers; they are five times stronger than steel on an equal-weight basis. They are used mainly as reinforcement materials for auto parts and defense gears, which require high-strength, lightweight materials. Kolon Industries has a 5,000-tonne production capacity, with a global market share of roughly 8% (vs. 50% for DuPont and 40% for Teijin). In 2009, DuPont filed civil and criminal suits against Kolon Industries, claiming it had encroached on its trade secrets. A settlement was reached in May 2015, after six years <Table 6>.

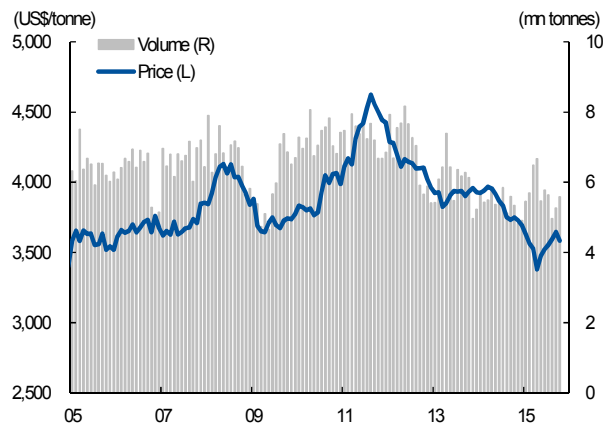
Consolidated subsidiaries include Kolon Glotech (2014 revenue of ₩618bn and operating profit of ₩21.6bn), which produces car seat materials and short-fiber polypropylene, and Kolon Plastics (2014 revenue of ₩245bn and operating profit of ₩6bn), which manufactures engineering plastic.

Figure 27. Tire cord



Source: KDB Daewoo Securities Research

Figure 28. Polyester tire cord prices



Source: KITA, KDB Daewoo Securities Research

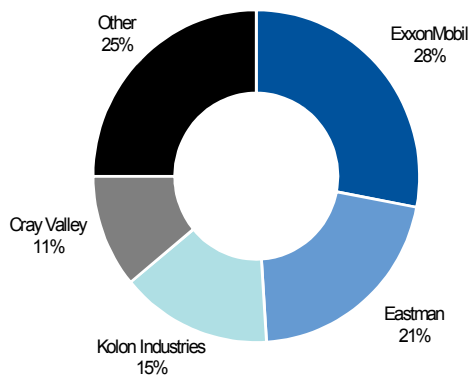
2) Chemicals

The chemicals unit contributed 24% of revenue in 2014. The unit produces hydrocarbon resins (more than 90% of chemicals revenue), phenol resin, and epoxy resin.

Hydrocarbon resins are used to increase the adhesive properties of tape, paint, ink, and rubber. They are made from petroleum-based feedstock using either C5 or C9. Hydrocarbon resins can also be hydrogenated; hydrogenated resins are used for diapers and hygiene products, as they are odorless and colorless and have greater stability towards heat and UV light. Demand for hygiene products is surging in emerging nations (e.g., China, India), while demand for adult hygiene products is growing in advanced nations, as well. With hygiene product sales expanding at an annual average rate of 6%, demand for hydrogenated resin is likely to grow steadily.

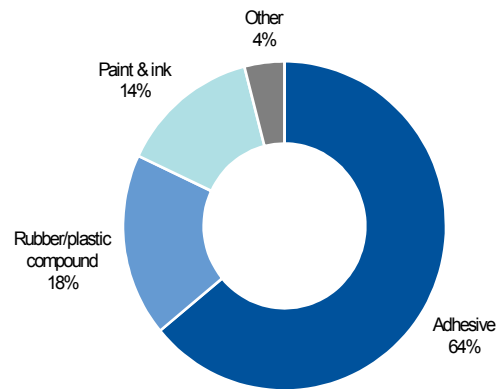
Kolon Industries is the world's third-largest hydrocarbon resin producer and Korea's sole producer. The company ramped up its hydrocarbon resin capacity by 30,000 tonnes in 2014, and capacity now stands at 150,000 tonnes (including hydrogenated resin capacity of 90,000 tonnes).

Figure 29. Hydrocarbon resins market share



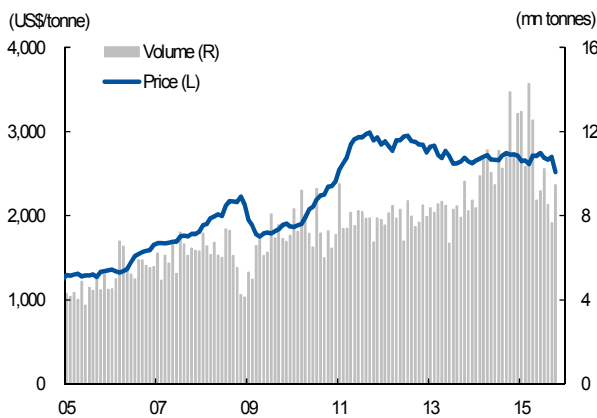
Source: Industry data, KDB Daewoo Securities Research

Figure 30. Hydrocarbon resin demand by product



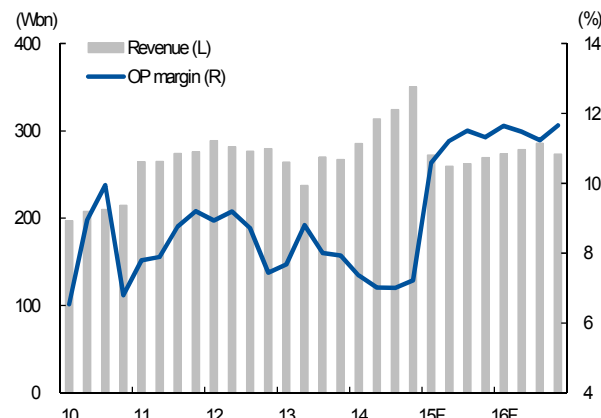
Source: Industry data, KDB Daewoo Securities Research

Figure 31. Hydrocarbon resin export prices and volume



Source: KITA, KDB Daewoo Securities Research

Figure 32. Chemicals earnings



Source: KDB Daewoo Securities Research

3) Films

The films unit generated revenue of W61.5bn in 2014, accounting for 12% of overall revenue. Products include base films (e.g., PET films, nylon films), diffuser films for use in displays, prism films and light guide panels for use in BLU, and dry film resists (DFRs) for use in printed circuit boards (PCBs). PET films have various applications (e.g., industrial manufacturing, optical materials, solar PV, and packaging).

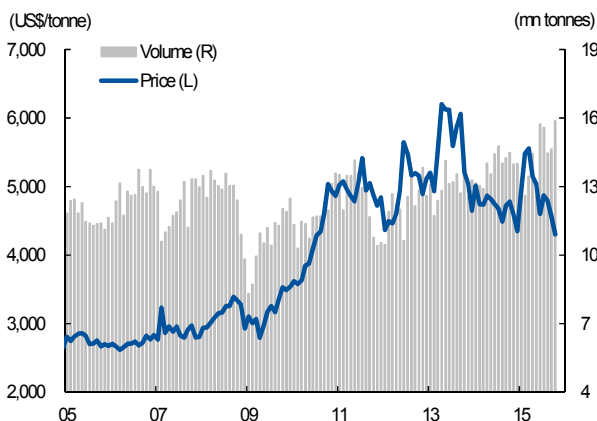
Kolon Industries' PET film capacity stands at 120,000 tonnes. As of 2014, the global PET film market capacity was 3.8mn tonnes. Major competitors include DuPont Teijin Films, Toray Industries, Mitsubishi Polyester Film GmbH, and SKC.

4) Fashion

The fashion unit recorded revenue of W124.9bn in 2014, accounting for 23% of overall revenue. The unit has a diverse lineup that includes outdoor/sporting brands (including the flagship Kolon Sport), men's wear, women's wear, accessories, and premium brands.

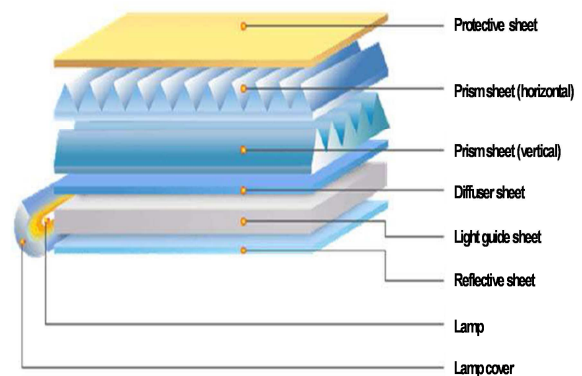
The outdoor apparel market has been slowing recently after surging in the early 2000s. However, Kolon Industries has expanded into China, where the outdoor apparel market is still in the initial stage of growth. The company increased the number of Chinese stores to 210 this year. The company's Chinese operations are progressing smoothly, with brands such as Couronne and Suecomma Bonnie having launched successfully.

Figure 33. PET film prices and volume



Source: KITA, KDB Daewoo Securities Research

Figure 34. Backlight unit (BLU) structure



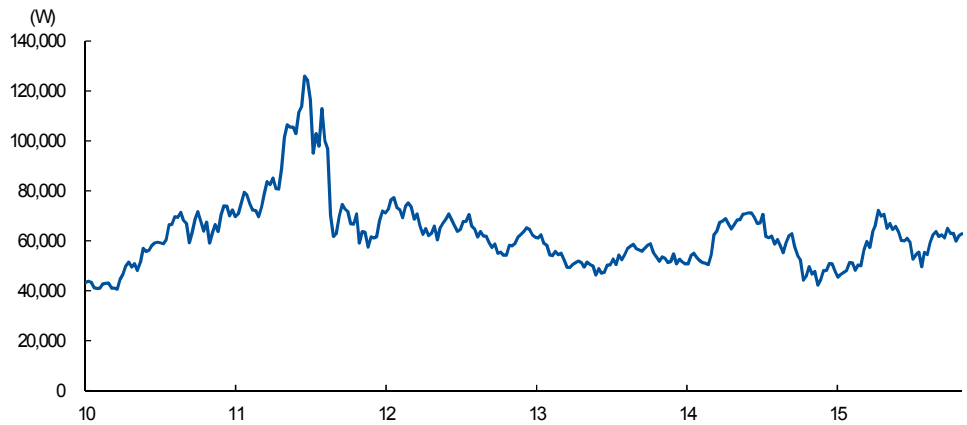
Source: Industry data, KDB Daewoo Securities Research

Figure 35. Kolon Industries' fashion brand lineup

OUTDOOR, SPORT&GOLF	MEN	WOMEN	CASUAL	ACC	PREMIUM
KOLON SPORT	customellow	LUCKY CHOUETTE	Henry Cottons MODERN COUNTRY	COURONNE	MARC JACOBS
ELORD	CAMBRIDGE MEMBERS	jardin de chouette	series; urban generation	SUECOMMA BONNIE	MARC BY MARC JACOBS
HEAD	CLUB CAMBRIDGE		RE:CODE		Berluti Paris Boutique Avenue des
JACK NICKLAUS SINCE 1962	GGIO ² CURATION				
	brentwood				
	SPASSO				

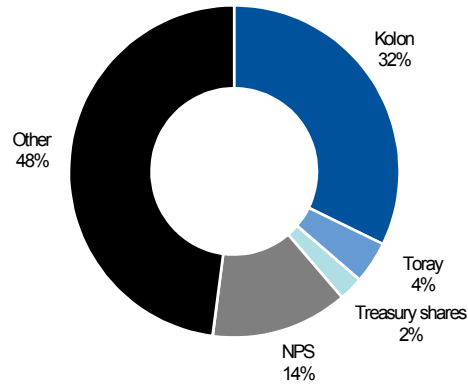
Source: Company data, KDB Daewoo Securities Research

Figure 36. Kolon Industries' share performance



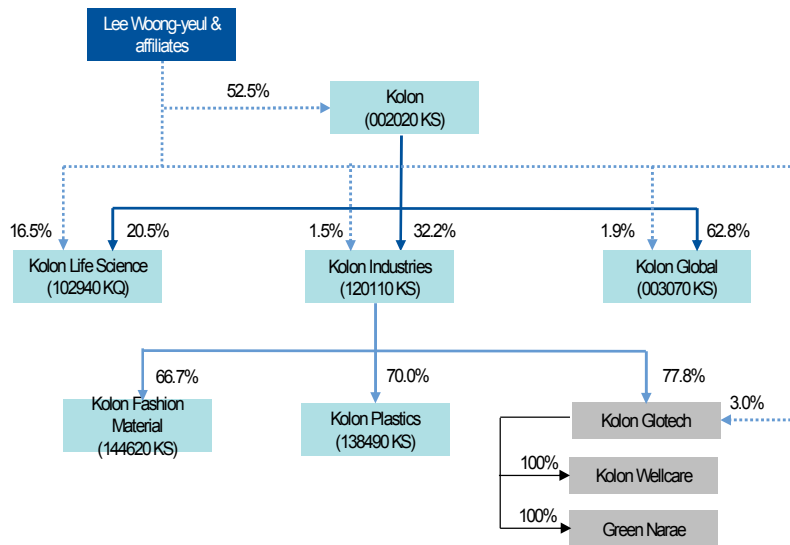
Source: Datastream, KDB Daewoo Securities Research

Figure 37. Kolon Industries' ownership



Source: Bloomberg, KDB Daewoo Securities Research

Figure 38. Kolon Industries' corporate governance



Source: DART, KDB Daewoo Securities Research

Kolon Industries (120110 KS/Buy/TP: W82,000)

Comprehensive Income Statement (Summarized)

(Wbn)	12/14	12/15F	12/16F	12/17F
Revenue	5,338	4,896	5,026	5,107
Cost of Sales	4,104	3,582	3,671	3,739
Gross Profit	1,234	1,314	1,355	1,368
SG&A Expenses	1,065	1,016	1,016	1,016
Operating Profit (Adj)	169	299	340	352
Operating Profit	169	299	340	352
Non-Operating Profit	-66	-407	-38	-26
Net Financial Income	-65	-65	-60	-54
Net Gain from Inv in Associates	40	20	29	29
Pretax Profit	103	-108	302	326
Income Tax	63	8	63	68
Profit from Continuing Operations	40	-116	238	257
Profit from Discontinued Operations	0	0	0	0
Net Profit	40	-116	238	257
Controlling Interests	42	-117	242	261
Non-Controlling Interests	-3	1	-3	-4
Total Comprehensive Profit	24	-49	238	257
Controlling Interests	26	-51	239	258
Non-Controlling Interests	-3	2	-1	-1
EBITDA	360	494	538	551
FCF (Free Cash Flow)	-80	103	226	221
EBITDA Margin (%)	6.7	10.1	10.7	10.8
Operating Profit Margin (%)	3.2	6.1	6.8	6.9
Net Profit Margin (%)	0.8	-2.4	4.8	5.1

Statement of Financial Condition (Summarized)

(Wbn)	12/14	12/15F	12/16F	12/17F
Current Assets	1,938	2,123	2,254	2,349
Cash and Cash Equivalents	62	261	356	410
AR & Other Receivables	891	950	969	989
Inventories	847	783	799	816
Other Current Assets	138	129	130	134
Non-Current Assets	2,811	2,927	2,943	2,956
Investments in Associates	225	208	212	216
Property, Plant and Equipment	2,151	2,178	2,187	2,194
Intangible Assets	160	177	178	177
Total Assets	4,749	5,049	5,197	5,305
Current Liabilities	1,744	1,956	1,922	1,878
AP & Other Payables	549	662	675	678
Short-Term Financial Liabilities	1,079	1,188	1,138	1,088
Other Current Liabilities	116	106	109	112
Non-Current Liabilities	996	1,147	1,097	997
Long-Term Financial Liabilities	765	767	767	717
Other Non-Current Liabilities	231	380	330	280
Total Liabilities	2,740	3,103	3,018	2,874
Controlling Interests	1,884	1,821	2,057	2,313
Capital Stock	139	139	139	139
Capital Surplus	906	907	907	907
Retained Earnings	891	766	1,002	1,258
Non-Controlling Interests	125	125	122	118
Stockholders' Equity	2,009	1,946	2,179	2,431

Cash Flows (Summarized)

(Wbn)	12/14	12/15F	12/16F	12/17F
Cash Flows from Op Activities	166	321	426	421
Net Profit	40	-116	238	257
Non-Cash Income and Expense	346	264	322	316
Depreciation	189	188	191	192
Amortization	3	6	7	7
Others	154	70	124	117
Chg in Working Capital	-156	188	-71	-83
Chg in AR & Other Receivables	18	-41	-19	-20
Chg in Inventories	12	69	-16	-17
Chg in AP & Other Payables	-104	81	10	11
Income Tax Paid	-64	-17	-63	-68
Cash Flows from Inv Activities	-175	-248	-198	-186
Chg in PP&E	-244	-214	-200	-200
Chg in Intangible Assets	-40	-16	-8	-6
Chg in Financial Assets	38	13	-3	-3
Others	71	-31	13	23
Cash Flows from Fin Activities	-52	-1	-129	-177
Chg in Financial Liabilities	13	110	-50	-100
Chg in Equity	0	1	0	0
Dividends Paid	-17	-15	-6	-6
Others	-48	-97	-73	-71
Increase (Decrease) in Cash	-62	199	95	54
Beginning Balance	124	62	261	356
Ending Balance	62	261	356	410

Source: Company data, KDB Daewoo Securities Research estimates

Forecasts/Valuations (Summarized)

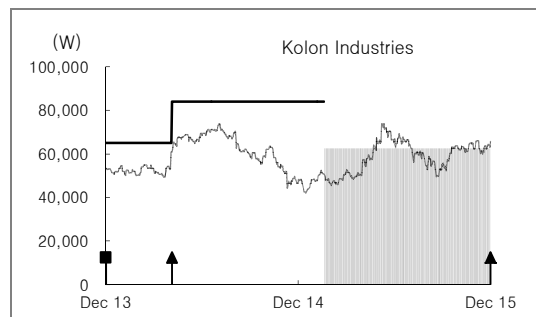
	12/14	12/15F	12/16F	12/17F
P/E (x)	31.9	-	7.6	7.0
P/CF (x)	3.5	12.4	3.3	3.2
P/B (x)	0.7	1.0	0.9	0.8
EV/EBITDA (x)	8.7	7.1	6.2	5.8
EPS (W)	1,517	-4,195	8,674	9,362
CFPS (W)	13,841	5,307	20,086	20,544
BPS (W)	67,609	65,292	73,761	82,918
DPS (W)	500	200	900	1,000
Payout ratio (%)	31.7	-4.3	9.5	9.8
Dividend Yield (%)	1.0	0.3	1.4	1.5
Revenue Growth (%)	1.5	-8.3	2.7	1.6
EBITDA Growth (%)	-13.0	37.2	8.9	2.4
Operating Profit Growth (%)	-27.2	76.9	13.7	3.5
EPS Growth (%)	-62.2	-	-	7.9
Accounts Receivable Turnover (x)	6.3	5.4	5.3	5.3
Inventory Turnover (x)	6.3	6.0	6.4	6.3
Accounts Payable Turnover (x)	10.2	8.0	7.4	7.4
ROA (%)	0.8	-2.4	4.7	4.9
ROE (%)	2.3	-6.3	12.5	12.0
ROIC (%)	1.9	9.1	7.6	7.8
Liability to Equity Ratio (%)	136.4	159.4	138.5	118.3
Current Ratio (%)	111.1	108.5	117.3	125.1
Net Debt to Equity Ratio (%)	86.0	84.4	68.7	55.2
Interest Coverage Ratio (x)	2.3	4.2	4.6	4.9

APPENDIX 1

Important Disclosures & Disclaimers

2-Year Rating and Target Price History

Company (Code)	Date	Rating	Target Price
Kolon Industries(120110)	12/01/2015	Buy	84,000
		No Coverage	
	04/06/2014	Buy	84,000
	11/15/2013	Trading Buy	65,000



Stock Ratings

Buy	: Relative performance of 20% or greater
Trading Buy	: Relative performance of 10% or greater, but with volatility
Hold	: Relative performance of -10% and 10%
Sell	: Relative performance of -10%

Industry Ratings

Overweight	: Fundamentals are favorable or improving
Neutral	: Fundamentals are steady without any material changes
Underweight	: Fundamentals are unfavorable or worsening

Ratings and Target Price History (Share price (—), Target price (—), Not covered (■), Buy (▲), Trading Buy (■), Hold (●), Sell (◆))

* Our investment rating is a guide to the relative return of the stock versus the market over the next 12 months.

* Although it is not part of the official ratings at Daewoo Securities, we may call a trading opportunity in case there is a technical or short-term material development.

* The target price was determined by the research analyst through valuation methods discussed in this report, in part based on the analyst's estimate of future earnings.

* The achievement of the target price may be impeded by risks related to the subject securities and companies, as well as general market and economic conditions.

Equity Ratings Distribution

Buy	Trading Buy	Hold	Sell
72.77%	13.86%	13.37%	0.00%

* Based on recommendations in the last 12-months (as of September 30, 2015)

Disclosures

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