MIRAE ASSET
Building on principles

Overweight (Maintain)

2H16 Outlook Report
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Daewoo Securities Co., Ltd.

[Shipbuilding & Machinery]

Ki-jong Sung
+822-768-3263
kijong.sung@dwsec.com

Ho-seung Lee
+822-768-4176
hoseung.lee@dwsec.com

Shipbuilding

Biggest transition in 40 years

Economic slowdown, oil prices, and order decline to weigh on shipbuilders

For 2H16, the shipbuilding market is expected to improve from 1H, but merchant vessel orders will likely remain weak amid the prolonged global economic slump and low oil prices. Orders for all vessel types except bulk carriers are expected to decline sharply. Order declines and stronger competition should inevitably drag down newbuilding prices. The offshore plant market is also anticipated to remain in a slump. Shipbuilders' investment plans could be delayed or cancelled depending on oil prices and economic conditions.

Newbuilding demand for tankers is forecast to rise on the back of Iran's crude oil export growth and higher oil demand from India. However, orders are unlikely to increase sharply. Containership orders are anticipated to fall steeply due to dismal global economic conditions and the end of the grace period for the application of stricter environmental standards. Bulk carrier orders will likely remain tepid, despite China's subsidy extension, due to weakening commodities demand and tonnage oversupply. Gas carrier orders should also contract in light of large-scale orders over the past several years.

The offshore plant market is unlikely to recover, as oil prices remain low. Moreover, financial institutions drastically cut their investments in resource development. Supermajors that have suffered earnings deteriorations are not expected to make new investments for the time being, and are expected to limit investments to some highly profitable oil wells. In particular, we expect to see delays and cancellations of a number of new drilling rig orders.

Desperately in need of restructuring

The global shipbuilding market is expected to deteriorate further in 2H due to a lack of orders and operating capital. The government must confront the choice of whether to pursue co-existence of existing players or let only the fittest survive. As for shipbuilders, carrying out restructuring to improve competitiveness is an urgent need.

The Japanese shipbuilding industry went through two rounds of major restructuring in the 1980s that cut the country's shipbuilding capacity in half. The global shipbuilding market needs to scale down capacity via consolidation. Since 2008, over 70% of the world's shipbuilders have either shut down or been sold to other companies, but global capacity has shrunk by just 40%.

In Korea, even large shipbuilders are weighed down by huge losses. Accordingly, the domestic shipbuilding industry is desperately in need of restructuring efforts via capacity cuts, consolidation, and business unit swaps.

Maintain Overweight; Top picks are HHI and HMD

We maintain our Overweight rating. The global shipbuilding market is likely to remain out of kilter next year, but the industry's restructuring should accelerate, reducing uncertainties for some competitive shipbuilders and helping them to display differentiated share performances going forward. However, if the government's support misfires and results in disruption or distortion in the market, this would put the industry under greater risk.

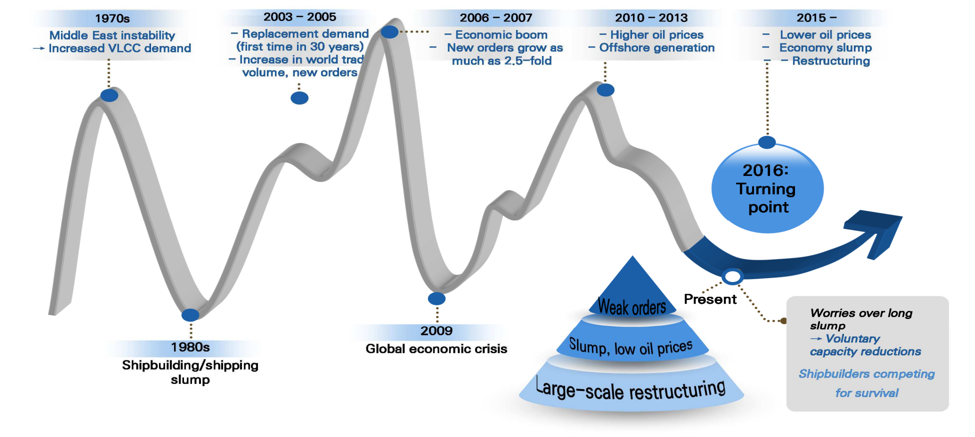
Hyundai Heavy Industries (009540 KS/Buy/TP of W142,000) stands to benefit the most from industry restructuring. The firm boasts strong financials and is competitive in the merchant ship segment. Its businesses are relatively stable thanks to a diversified portfolio. We maintain our Hold stance on Samsung Heavy Industries (010140 KS) and Daewoo Shipbuilding & Marine Engineering (042660 KS) in light of the great uncertainties over orders and financial conditions. .

Hyundai Mipo Dockyard (010620 KS/Buy/TP of W100,000) has started to turn around, and is likely to report stable earnings on a recovery in orders. We reiterate Hold on Hanjin Heavy Industries & Construction (097230 KS), as slow progress in asset sales (including real estate) should keep the shipbuilder's financial burden high.

C O N T E N T S

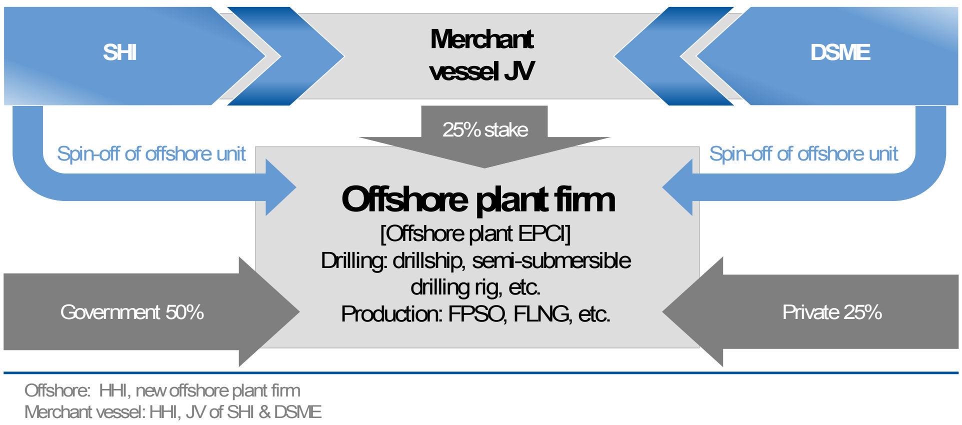
[Summary] Korean shipbuilders' restructuring

Figure 1. Shipbuilding industry history



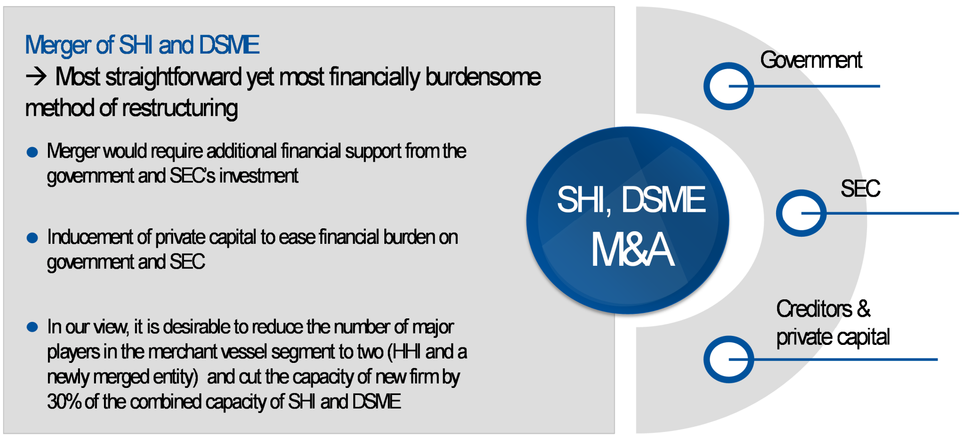
Source: Daewoo Securities Research

Figure 2. Restructuring scenario ①



Source: Daewoo Securities Research

Figure 3. Restructuring scenario ②



Source: Daewoo Securities Research

I. 1H16 review: Absence of orders

1. Merchant vessels: Suffering from a lack of orders

The global shipbuilding industry in 1H16 looks much weaker than previously anticipated. Globally, merchant vessel orders in 1Q16 plunged 70% YoY to 2.4mn CGT, similar to the post-crisis level. The big three domestic shipbuilders did not receive a single order in 1Q, while orders in January-April shrank 63% YoY to 380,000 CGT.

The sharp drop in shipbuilding orders is attributable to several factors. First, orders for mega-sized containerships surged in 2015, as shippers took advantage of the grace period before the application of the Environmental Protection Agency's (EPA) Tier 3 emission standards. Second, the global financial market sharply contracted at end-2015 as the possibility of a financial crisis in the eurozone emerged, weighing heavily on the global ship financing environment. Third, despite the recent rebound in oil and commodities prices, shippers are not rushing to place orders amid ongoing uncertainties over the global economy.

2. Offshore plants: Slump persists

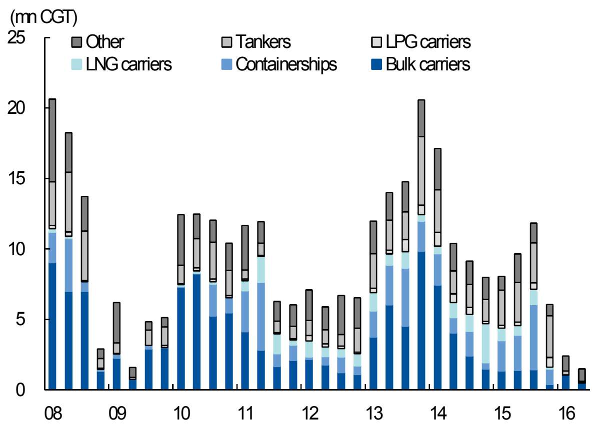
The global offshore plant market is not expected to get on the path to recovery as long as oil prices remain low. Financial institutions as well as oil majors have halted investments. This year, we have seen no new orders for drilling facilities (including drill ships and semi-submersible drilling rigs). As for already-placed orders, some have been cancelled or delayed. In our view, risks remain intact as oil prices are unlikely to increase significantly.

Increasingly, capex has been suspended or pushed back. Last year, Royal Dutch Shell indefinitely suspended the final investment decision for three FLNG orders awarded to Samsung Heavy Industries (SHI), and cancelled previously placed orders.

3. Restructuring efforts have begun to materialize

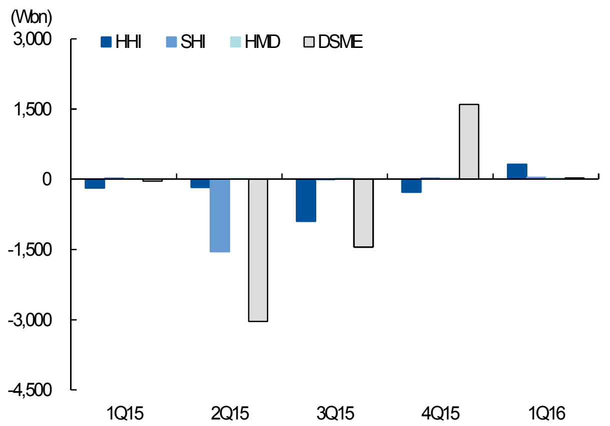
The domestic shipbuilding industry has been undergoing restructuring for several years. Shipbuilders have received no additional orders for offshore plants, which bear high order cancellation risks. Troublesome projects have been completed or have progressed significantly, sharply reducing the likelihood of additional losses. On the back of restructuring and productivity improvement, shipbuilders turned around in 1Q and are expected to deliver stable earnings going forward.

Figure 4. Quarterly newbuilding orders



Source: Daewoo Securities Research

Figure 5. Korean shipbuilders' quarterly earnings



Source: Daewoo Securities Research

II. Issue: The greatest transition in 40 years

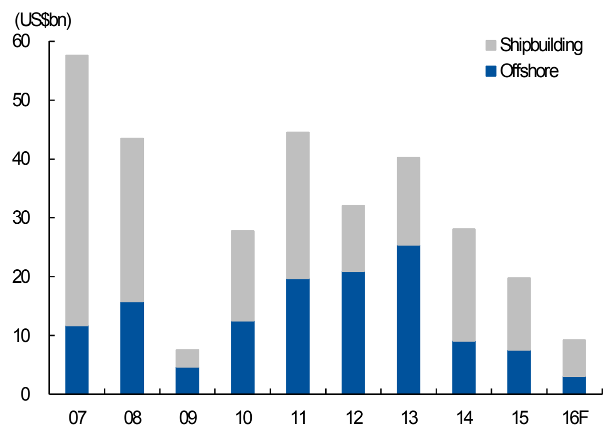
1. Market slump → Order decline → Weak order backlogs

The global economic slowdown and low oil prices have depressed newbuilding orders. Orders decreased further in 2016, as the grace period before the application of the Tier 3 emission standards ended last year. Although oil prices recently turned upward, the impact does not appear to be spilling over into the real economy due to lingering economic uncertainties.

In 1H, domestic shipbuilders are experiencing a lull in orders. For the full year, newbuilding orders are projected to plunge to half the 2015 level, dragging down order backlogs to about one year's worth of work. The order backlogs of the three major domestic shipbuilders, stripping away vessels currently under construction, average just one and a half years. As such, shipbuilders are expected to further speed up restructuring. In addition to asset disposal and workforce reduction, capacity cuts seem unavoidable.

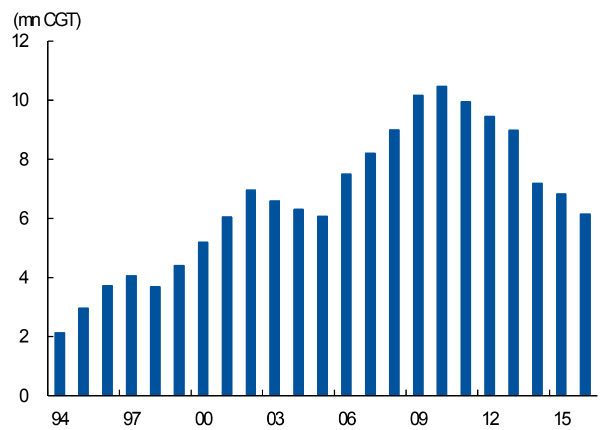
In Korea, the five biggest shipbuilders—Hyundai Heavy Industries (HHI), SHI, Daewoo Shipbuilding & Marine Engineering (DSME), Hyundai Samho Heavy Industries (HSHI), and Hyundai Mipo Dockyard (HMD)—account for 85% of the industry's total capacity. The concentration of capacity in a small number of players has led to overcapacity in the industry. Although the number of shipbuilders has fallen to around 10 (from 26 in 2009), capacity has been reduced by just 30%.

Figure 6. "Big three" Korean shipbuilders' new orders and outlook



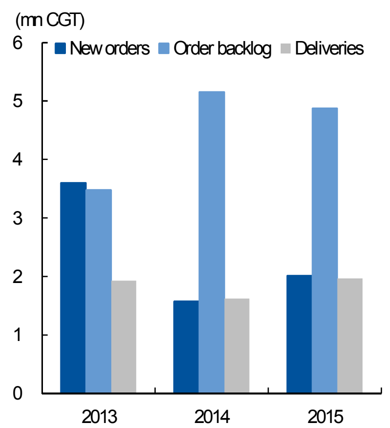
Source: Daewoo Securities Research

Figure 7. Korean shipbuilding capacity



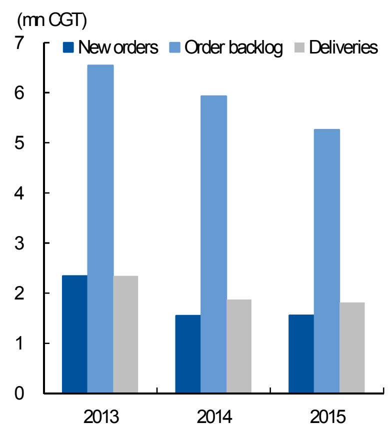
Source: Daewoo Securities Research

Figure 8. HHI's new orders, backlog, and deliveries



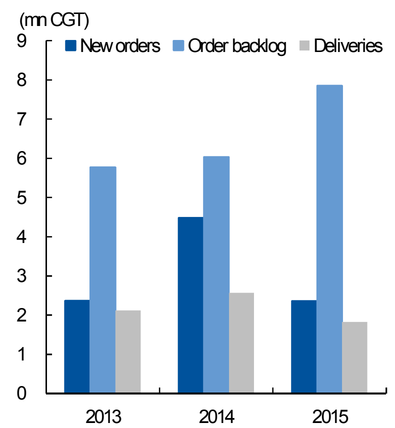
Source: Daewoo Securities Research

Figure 9. SHI's new orders, backlog, and deliveries



Source: Daewoo Securities Research

Figure 10. DSME's new orders, backlog, and deliveries



Source: Daewoo Securities Research

2. In urgent need of financial aid

The global merchant vessel market sharply contracted after the global financial crisis in 2009, with small- and mid-sized shipbuilders undergoing restructuring. So far, about 70% of the world's shipbuilders have either shut down or been sold to other companies, and production capacity has been slashed by more than 40%. In Korea, small- and mid-sized players with weaker competitiveness have been forced out of the market. Meanwhile, large-sized shipbuilders shifted their focus to offshore plants in order to maintain growth.

Despite their lack of experience, the three major domestic shipbuilders engaged in cut-throat competition in the offshore plant market, agreeing to tight schedules and accepting "heavy-tail" payment schemes (receiving most of the money in the final phase of construction) for orders. Amid low oil prices, shipbuilders have incurred massive losses from these projects.

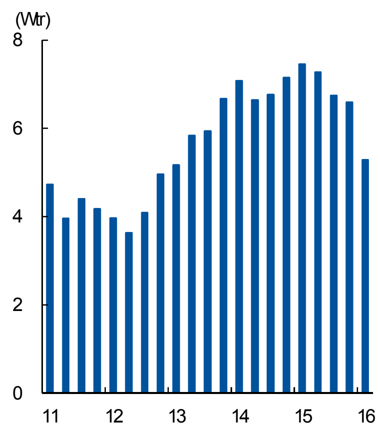
If oil prices remain low, shipbuilders might record additional losses in light of their heavy backlogs of drilling and production facility orders with the heavy-tail payment method.

Table 1. 2015 earnings & cumulative losses

	HHI (009540)	SHI (010140)	DSME (042660)
Reason for losses	Insufficient experience/competence, excessive investments in production equipment (intensifying competition → process disruptions → impact on drilling equipment & shipbuilding)		
Account receivables (2014 → 2015) **2015 revenue** **2015 operating profit**	W7.2tr → W6.6tr W46.2tr -W154bn	W5.5tr → W4.3tr W9.7tr -W1.5tr	W7.4tr → W5.5tr W15tr -W3tr
Loss breakdown	Hyundai Samho: W120bn Offshore: W290bn	Large EPC 3 unit, drilling equipment + shipbuilding W1.6tr	W2.5tr (offshore) + W450bn (shipbuilding) +W250bn (reserve) = W3.2tr
Total losses (cumulative)	W3.5tr (HHI W1.5tr + HSI W1tr + HMD W1tr)	W2.2tr (CPF+FPSO W1.24tr, FLNG+ drillship W0.7tr, rig + shipbuilding W0.26tr)	W3.65tr Reserve: W700bn (including overseas corporation) + reduction in revenue: W2.9tr (unclaimed construction)
Offshore order backlog (as of 1Q)	US$14.4bn	US$19.7bn	US$19.3bn
Debt ratio	222%	Over 300%	Under 800% (partial impairment of capital)

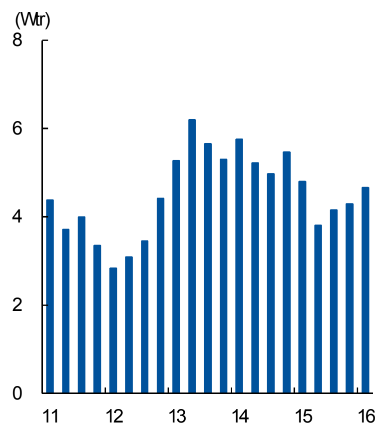
Source: Company audit report, Daewoo Securities Research

Figure 11. HHI's unclaimed payments for construction



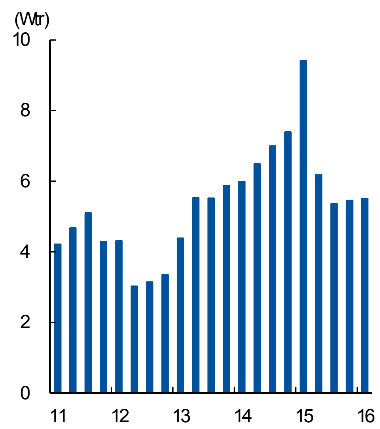
Source: Daewoo Securities Research

Figure 12. SHI's unclaimed payments for construction



Source: Daewoo Securities Research

Figure 13. DSME's unclaimed payments for construction



Source: Daewoo Securities Research

3. Chinese government rolls up its sleeves

1. China cuts back on financial support to shipyards

Facing a global supply glut, the Chinese government has shifted its stance from unlimited financial support to restructuring (though it decided to increase ship finance for exported vessels and maintain financial support for the offshore plant segment).

2. Government white-lists shipyards

In November 2013, the Ministry of Industry and Information Technology (MIIT) formulated and issued the Shipbuilding Industry Regulatory Requirements in an effort to ease industry-wide overcapacity, carry out restructuring, improve market concentration, and enhance business sustainability. As part of such efforts, the ministry released a white list of 50 quality shipyards in September 2014. It added 10 more companies to the list in December of the same year, and listed another 11 in February of this year. Companies that did not make the list are likely to be excluded from bank loans and eventually undergo restructuring.

In August 2014, the Chinese government announced a plan to upgrade and restructure its troubled shipbuilding industry. State-led restructuring commenced in October of the same year, as the government forced large builders to swap business units or to acquire small- to medium-sized shipbuilders. This year, less competitive and/or non-viable shipbuilders have continued being sold off or forced to shut down their businesses. Furthermore, Chinese shipbuilders were restricted from expanding capacity for three years starting end-2014.

China's past shipbuilding industry development policies mostly targeted state-owned firms including China State Shipbuilding Co. (CSSC) and China Shipbuilding Industry Co. (CSIC). However, these firms have not been immune from the government's restructuring drive, with some subsidiaries of these state-owned shipyards (two CSIC subsidiaries, two COSCO subsidiaries, and three CSC subsidiaries) being delisted during the second round of the white list revision.

3. Proactive restructuring and transparent white list selection process

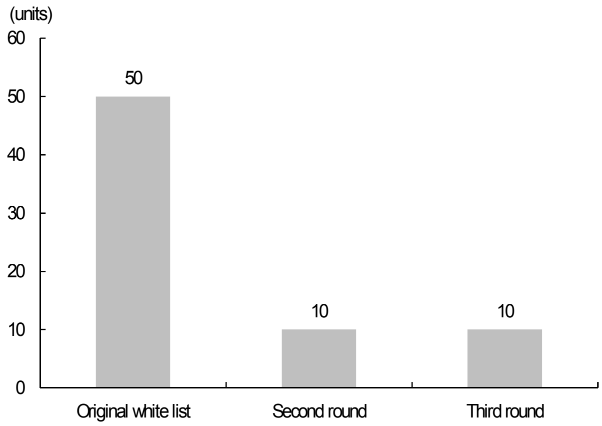
We believe there are some lessons to be learned by the Korean government from its Chinese counterpart's handling of shipyards. China has been proactive in restructuring the troubled industry, and drew up the white list under the clear guidance of the Shipbuilding Industry Regulatory Requirements. As banks review loan eligibility, government influence is minimized. Whether these restructuring efforts will actually be effective in strengthening shipbuilding capabilities remains to be seen.

Table 2. Shipbuilding policies of the Chinese government

	Content
Goals	1. 70% of shipbuilding capacity concentrated among country's 10 largest shipbuilders 2. Five Chinese firms to be among world's 10 largest shipbuilders 3. Five to six Chinese shipyards to grow into global offshore plant builders 4. 70% of shipbuilding materials purchased from Chinese makers
7 action plans	1. Step up R&D in energy conservation and environmental protection technologies 2. Enhance medium/high-speed engines and offshore plant facilities 3. Industry restructuring - Enhance global competitiveness and market concentration through M&As 4. Scrap old ships, and strengthen offshore plant development and LNG carrier construction capabilities 5. Gain market share and tap into new markets - Build R&D centers and attract offshore plant specialists 6. Promote partnerships with the private sector in the defense industry - Jointly design/manufacture military vessels 7. Tighten business management - Revamp corporate structures and introduce cost-cutting technologies
Gov. support	1. Support replacement of aging ships (for those that submitted scrapping applications by end-2015) 2. Expand ship finance 3. Enhance technological innovation (R&D)

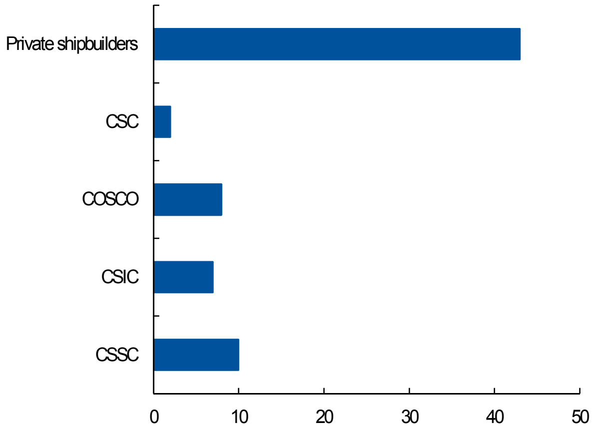
Source: MIIT, Mirae Asset Daewoo Securities Research

Figure 14. Viable Chinese shipyards included in white list



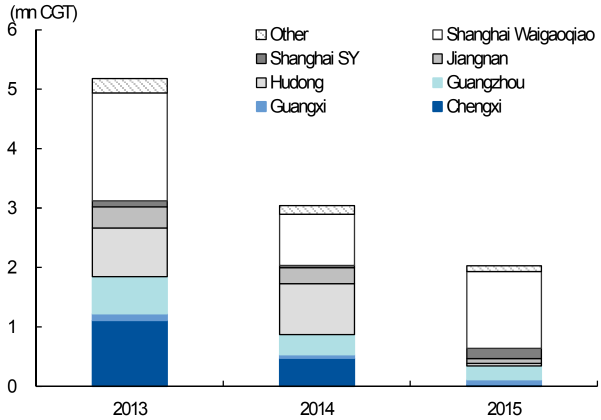
Source: Daewoo Securities Research

Figure 15. Viable Chinese shipbuilders included in white list



Source: Daewoo Securities Research

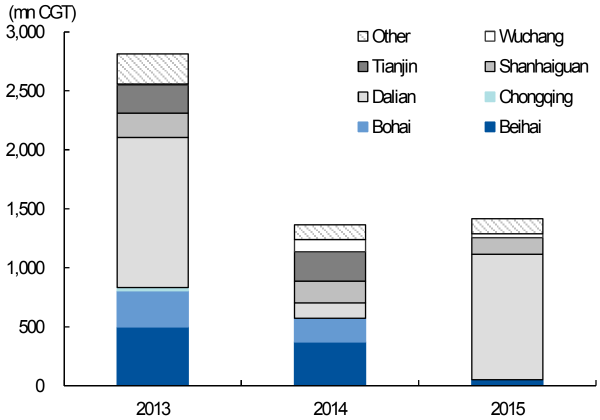
Figure 16. Overview of CSSC Holdings



(US$mn)	2013	2014	2015
Revenue	3,604	4,587	4,409
Operating profit	-86	-43	-43
Net profit	6	7	10
OPM (%)	-2.4	-0.9	-1.0
Total asset	8,431	8,343	7,912
Total liability	5,158	5,186	4,915

Source: Daewoo Securities Research

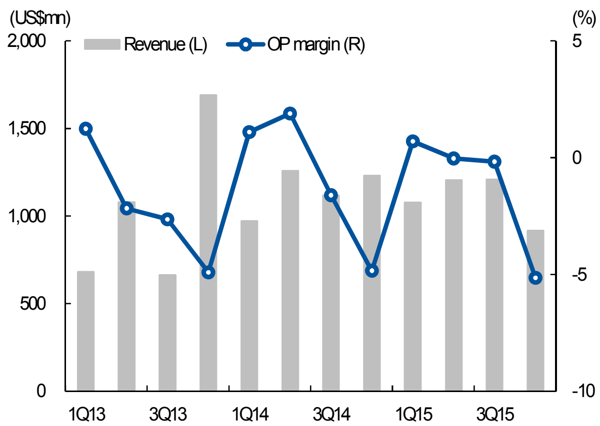
Figure 17. Overview of CSIC Holdings



(US$mn)	2013	2014	2015
Revenue	9,346	9,799	9,180
Operating profit	429	126	-326
Net profit	535	369	-58
OPM (%)	4.6	1.3	-3.5
Total asset	32,001	33,268	32,754
Total liability	23,289	23,214	23,212

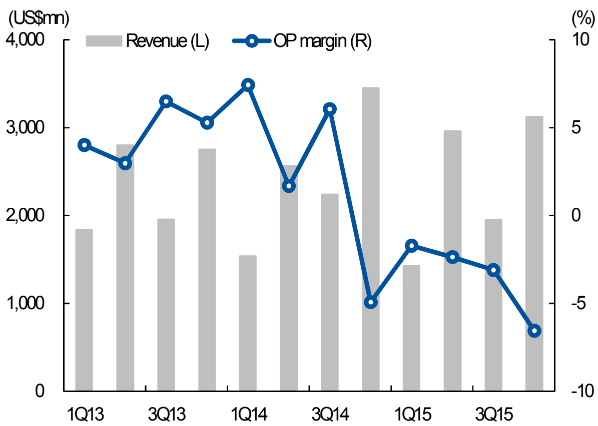
Source: Daewoo Securities Research

Figure 18. CSSC's revenue and OP margin



Source: Daewoo Securities Research

Figure 19. CSIC's revenue and OP margin



Source: Daewoo Securities Research

4. Lessons from history

1. Japan's shipbuilding history

In the 1970s, Japan dominated the global shipbuilding market, of which it controlled more than 50%. In the 1980s, however, Japanese shipbuilders went through two rounds of massive government-led restructuring due to the global economic slump. As a result, the number of Japanese shipbuilders shrank from 61 to 26, while production capacity was cut by more than half due to a restriction on the number of ships in production per dock.

In the process, most major Japanese shipbuilders took drastic steps to reduce their shipbuilding businesses and expand plant and aerospace investments. Although their market dominance has gone away, they are still in business thanks to their restructuring efforts, with their global shipbuilding market share hovering at around 20%.

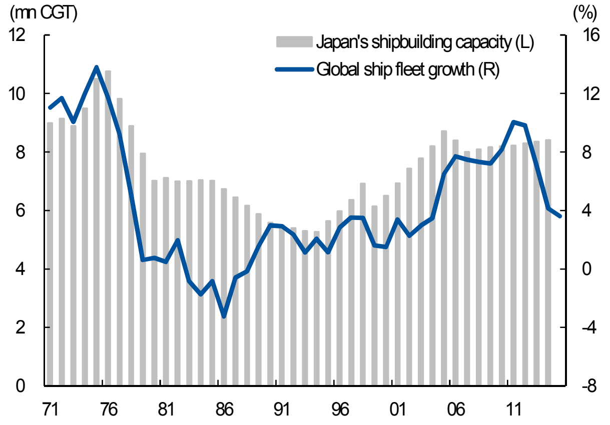
We believe the example of Japanese shipbuilders is instructive, as they were able to overcome a sharp market slump via massive restructuring, capacity reduction, and expansion into other businesses.

Table 3. Japan's shipbuilding restructuring cut capacity in half

	Before first restructuring (March 1980)	After first restructuring	After second restructuring (March 1988)
No. of companies	61	44	26
No. of groups	-	11	8
No. of docks	138	73	46
Capacity	9.6mn CGT	6.0mn CGT (-33%)	4.6mn CGT (-24%)

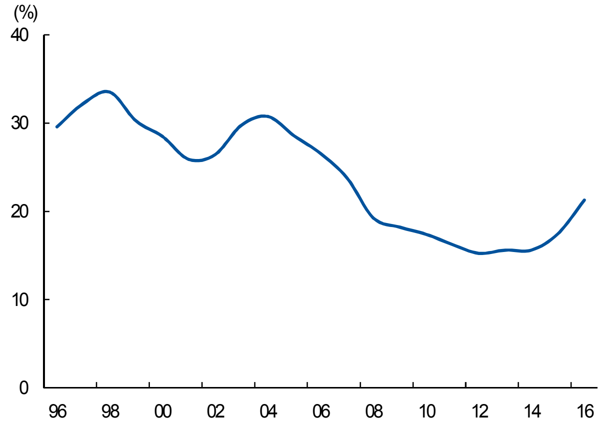
Source: Shipbuilders' Association of Japan, Daewoo Securities Research

Figure 20. Global fleet growth & Japan's shipbuilding capacity



Source: Daewoo Securities Research

Figure 21. Japan's shipbuilding global M/S



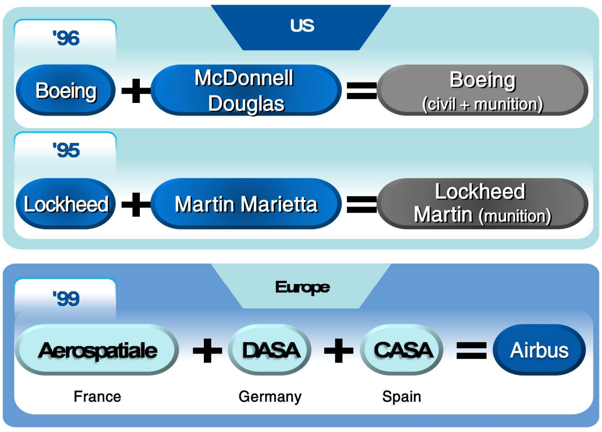
Source: Daewoo Securities Research

2. Global civil aircraft industry

In the global civil aircraft industry, large-scale mergers in the US and Europe resulted in a duopoly in the market for large jet airliners. In the US, Boeing and McDonnell Douglas were merged into Boeing in 1996, while in Europe, Aerospatiale (France), DASA (Germany), and CASA (Spain) were merged into Airbus in 1999.

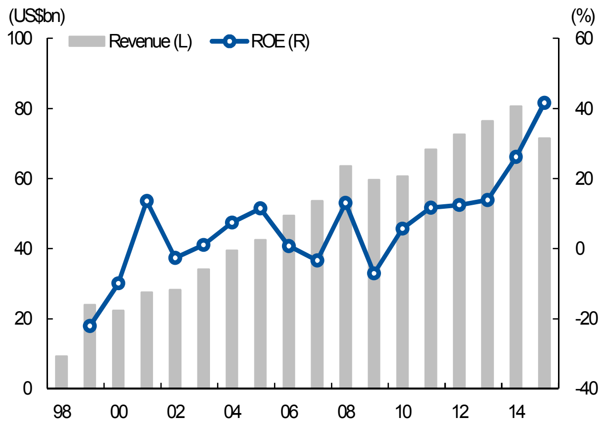
Since the industry's reorganization, the two civil aircraft makers have outsourced the production of components to other countries, including Japan, China, and Korea, while assembling them in their own countries (the US for Boeing and France for Airbus). In addition, as competition has eased, they have focused on strengthening their corporate fundamentals rather than pursuing growth. Indeed, Airbus and Boeing have both delivered modest but stable growth in earnings and ROE since the mergers.

Figure 22. Global aircraft market restructuring



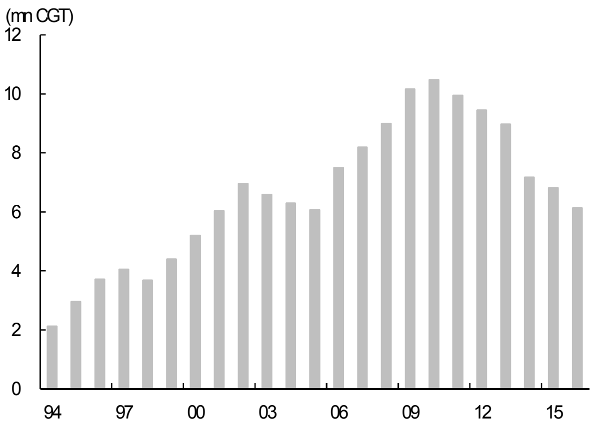
Source: Daewoo Securities Research

Figure 23. Airbus's earnings



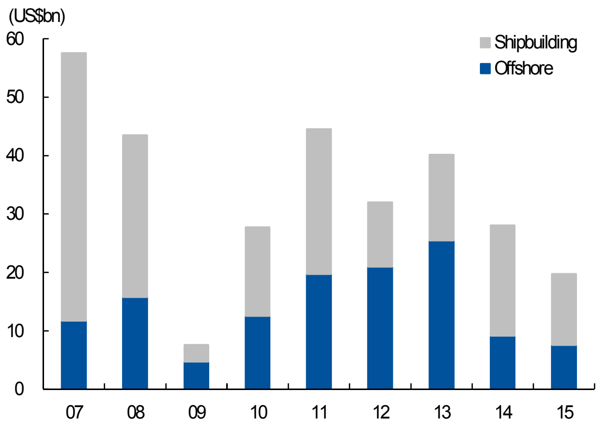
Source: Daewoo Securities Research

Figure 24. Korean shipbuilding capacity



Source: Daewoo Securities Research

Figure 25. "Big three" Korean shipbuilders' new orders



Source: Daewoo Securities Research

5. Korean shipbuilders to face a new era after 40 years of expansion

1. Proactive restructuring required

We think that shipbuilding capacity reductions are inevitable at home and abroad, in light of the global economic downturn, a prolonged recession in the shipbuilding industry, and the competitive dynamics of Japanese and Chinese shipyards. Capacity expansion is no longer a growth driver for anyone in the troubled shipbuilding industry.

Korean shipbuilders, either voluntarily or involuntarily, will also need to reinvent themselves by cutting capacity. Keeping all large builders alive with government life support does not appear a viable option anymore.

2. Enhancing industry competitiveness

The global shipbuilding industry was thrown into turmoil in the wake of the global financial crisis, and massive restructuring has ensued. Financial institutions took the lead in restructuring small shipyards, while for bigger ones, government intervention was the trigger point. In Korea, the top-five shipyards account for more than 85% of total shipbuilding capacity, with the top-three players engaging in aggressive, cut-throat competition that has depressed margins at all three firms.

In Korea, the government often comes to the rescue when an industry is struggling. This time, however, the government seems to think it unwise to support all of the ailing shipbuilders, given the massive scale of losses. It seems increasingly likely that the government will spearhead major restructuring efforts to minimize losses.

Back in the late 1990s, government-led restructuring efforts mostly focused on industry rationalization. This time, however, we believe that restructuring should aim at strengthening industry competitiveness. If necessary, the government should not shy away from drastic measures such as M&As among top players, rather than simply injecting liquidity to sustain insolvent businesses.

For the latest round of restructuring to be successful, we think each business needs to focus on what they can do well. As Korean shipyards have strong growth potential and superior competitiveness individually, they will likely remain on top of the global shipbuilding market once efforts to strengthen industry competitiveness are made.

3. Korean shipbuilders' competitiveness remains intact

Korean shipbuilders still have the highest competitiveness in the global market. We expect them to maintain their market leadership despite intense competition from Chinese and Japanese shipbuilders. In particular, Korean shipbuilders are far ahead of Chinese peers in in terms of quality, experience, reliability, and the ability to design cutting-edge products. In addition, Korean shipbuilders are unrivalled in building value-added vessels, including LNG/LPG carriers, FSRUs, VLECs, mega-sized containerships, and pure car/truck carriers (PCTCs). Even for VLCCs, many shippers prefer Korean shipbuilders to Chinese builders. Furthermore, Korean builders boast more advanced eco-friendly ship technology.

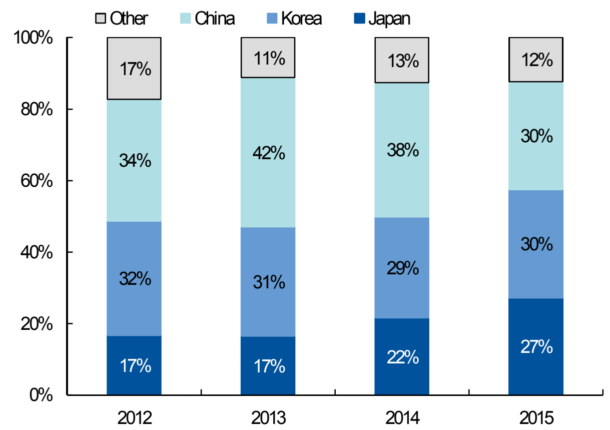
The same can be said of the floating offshore plant market. Major domestic shipbuilders have been dominant in this market, although they have recently incurred massive losses on offshore plants. In the event of a recovery in the offshore plant market amid a pickup in oil prices, major domestic shipbuilders are expected to gain robust earnings momentum.

Table 4. Large-size containership construction: Technological gap with Korea **(p, years)**

	Korea	Japan	Europe	US	China
Technological level (p)	100	91.1	89.4	80.3	76.6
Technological gap (years)		1.1	1.3	2.1	2.7

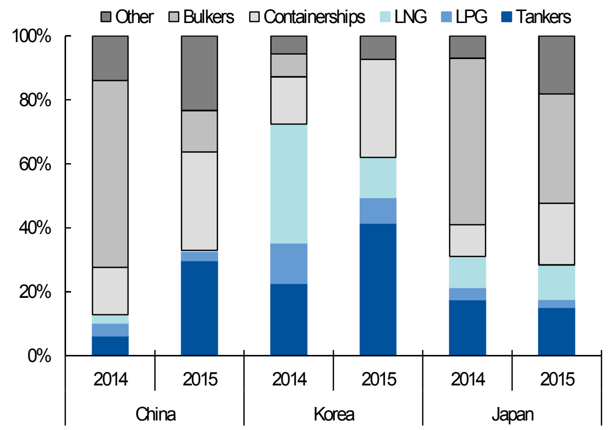
Source: Ministry of Trade, Industry and Energy, KEIT, Daewoo Securities Research

Figure 26. Market share breakdown by country (based on orders)



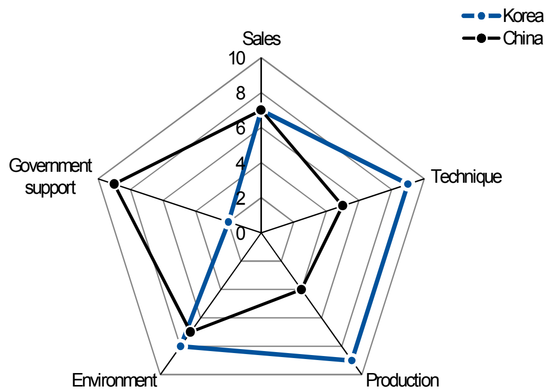
Source: Daewoo Securities Research

Figure 27. Japanese & Chinese firms competing fiercely in the bulker segment



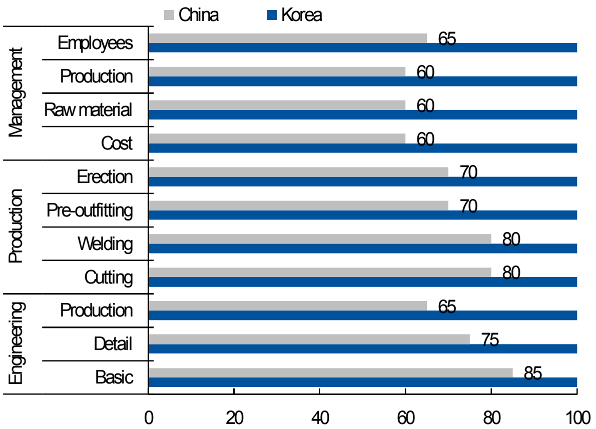
Source: Daewoo Securities Research

Figure 28. Korea vs. China: Competitiveness evaluation



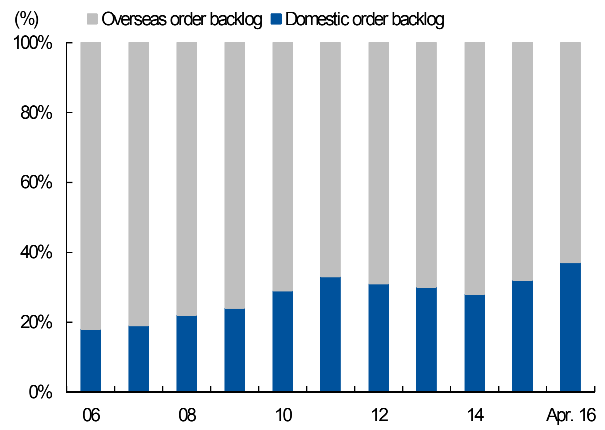
Source: Daewoo Securities Research

Figure 29. Korea vs. China: Technological gap



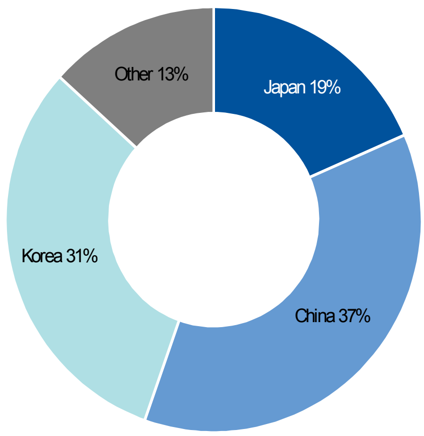
Source: Daewoo Securities Research

Figure 30. Chinese order backlog breakdown



Source: Daewoo Securities Research

Figure 31. Korea, China, Japan order M/S (cumulative over 5 years)

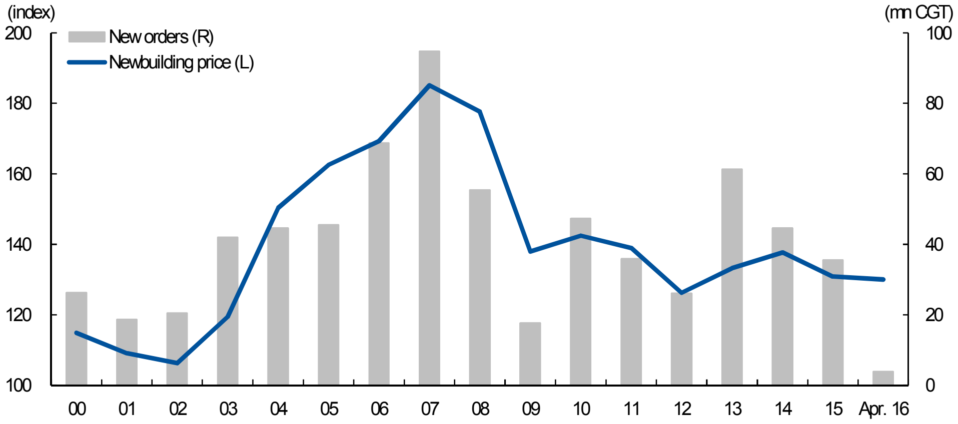


Source: Daewoo Securities Research

III. 2016 merchant vessel market outlook

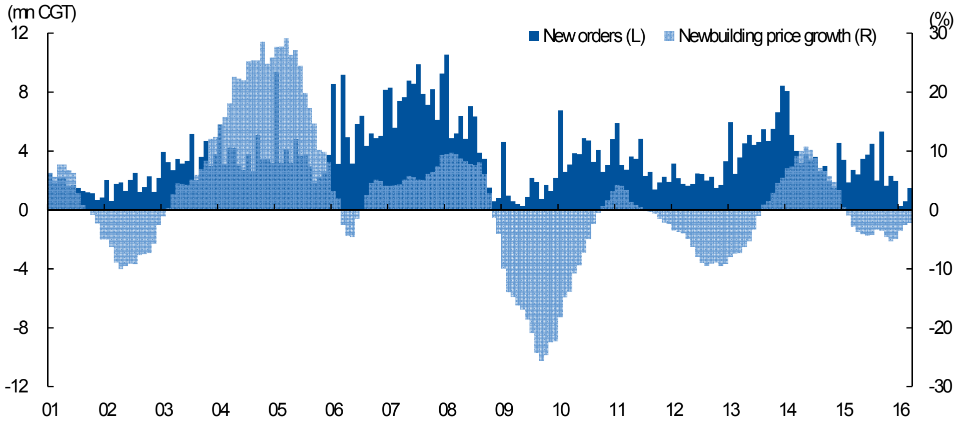
1. Global economic slump and low oil prices: Orders to decrease sharply

Figure 32. New orders & newbuilding price trend



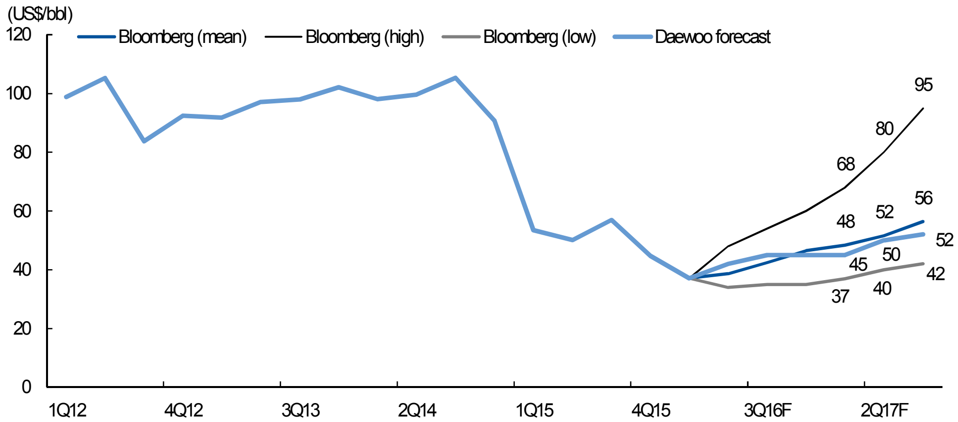
Source: Daewoo Securities Research

Figure 33. Newbuilding price growth & new orders



Source: Daewoo Securities Research

Figure 34. Oil price trend & forecast



Source: Daewoo Securities Research

2. Sluggish orders likely across the board

1. Expectations for the tanker and gas carrier markets remain intact

Tanker demand, which surged temporarily on lower oil prices, has weakened again. In 2H, we expect newbuilding orders to remain sluggish due to economic uncertainties. However, expectations for Iran and India are high.

We expect to see massive demand for tankers and gas carriers from Iran thanks to the lifting of US sanctions. According to the Ministry of Trade, Industry and Energy (MOTIE), Iran will likely need tankers and gas carriers worth US$18bn. However, the country's lack of financial resources could pose a major stumbling block. Competition with Chinese shipbuilders, which receive government subsidies, will likely intensify to win orders from Iran.

In India, demand for crude oil and gas has been rising markedly on the country's rapid economic growth. We expect to see large-scale shipbuilding orders in light of 1) government efforts to induce Indian shippers to raise the proportion of in-house ships in their fleets, and 2) increasing replacement demand.

The overall gas carrier market will likely contract YoY amid the global economic slowdown. However, in addition to LNG and LPG carrier orders from Iran and India, orders for specialty vessels, including FSRUs, are also likely to expand, aided by higher demand for offshore bunkering systems resulting from rising global demand for natural gas and LPG.

2. Containership and bulk carrier market to remain in a lull

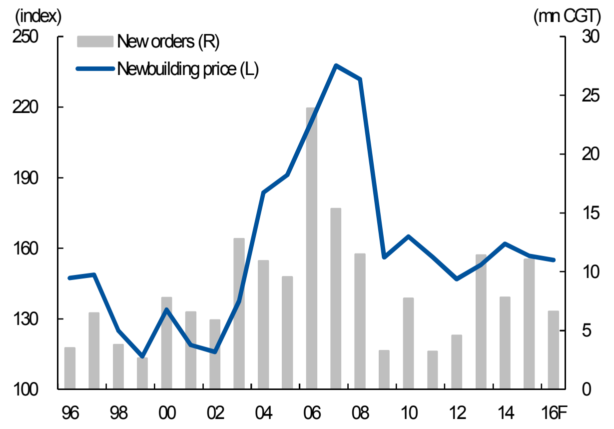
The containership market was strong in 2015, as orders for mega-sized containerships surged as shippers took advantage of the grace period before the application of the Environmental Protection Agency's (EPA) Tier 3 emission standards. In 2016, ship prices have climbed, while freight rates have fallen amid the economic slowdown, increasing the burden of excessive orders placed last year. Of note, both the Howe Robinson Container Index (HRCI; long-term) and the China Containerized Freight Index (CCFI, short-term) are on the downswing. Therefore, unless the economy shows clear signs of a recovery, mega-sized containership orders are unlikely to occur for the time being. However, orders for small-sized feeder ships are expected to be placed.

We expect the bulk carrier market to remain in a slump in 2016, as: 1) tonnage oversupply will persist despite the lingering economic slump; 2) the BDI, which has recently picked up, is likely to stay below the level at which shippers make profits; and 3) although the Chinese government extended subsidies to local shippers for scrapping old ships, the number of old ships eligible for demolition decreased, meaning less room for newbuilding order growth.

Bulk carrier orders will likely increase modestly YoY, as Chinese shippers placed orders for 30 VLOCs to Chinese shipbuilders in 1H.

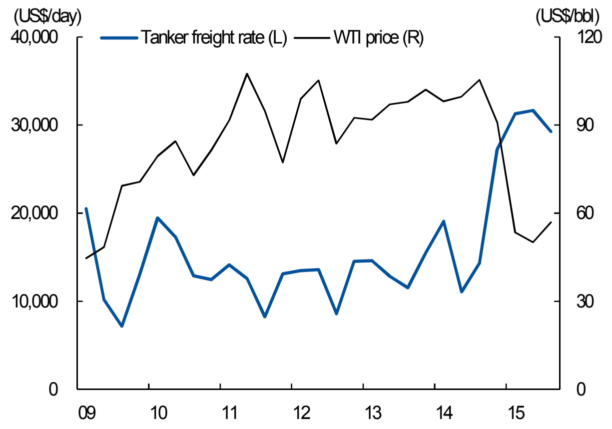
Since the beginning of the year, the BDI has soared 60% to 622p, aided by iron ore restocking in China. However, additional demand is unlikely to occur, given China's high commodity inventories. Therefore, we think the bulk carrier market will not recover anytime soon, unless the real economy recovers.

Figure 35. Tanker orders and price trend



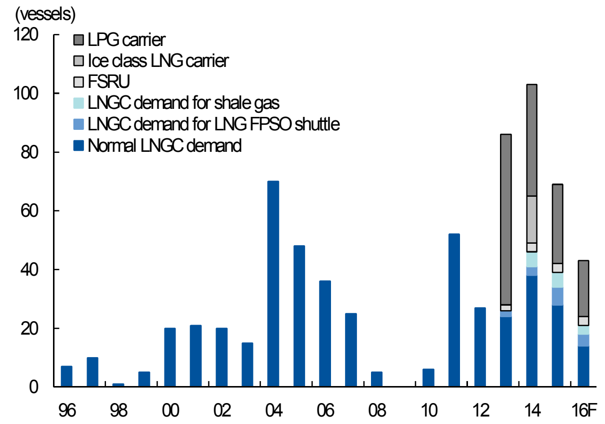
Source: Daewoo Securities Research

Figure 36. Oil price and tanker freight trends



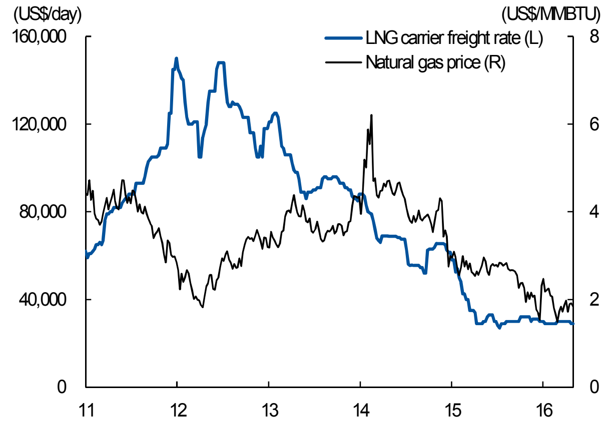
Source: Daewoo Securities Research

Figure 37. LNG carrier order trend & forecast



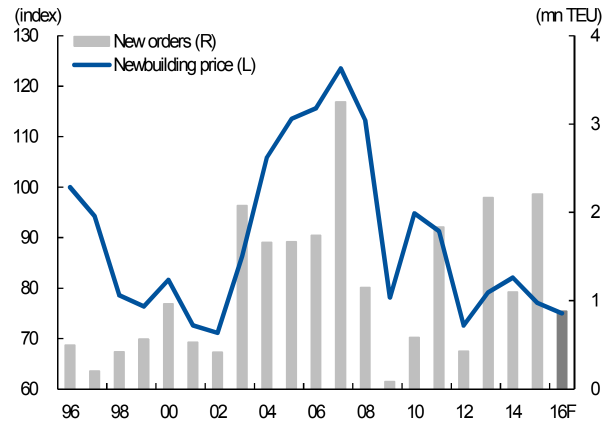
Source: Daewoo Securities Research

Figure 38. LNG carrier freight rate & natural gas price



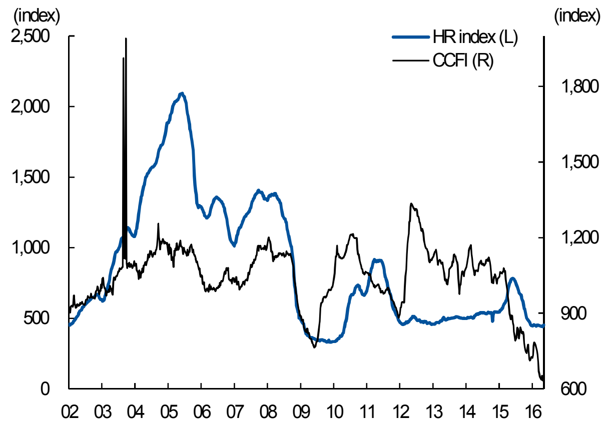
Source: Daewoo Securities Research

Figure 39. Containership orders and price trend



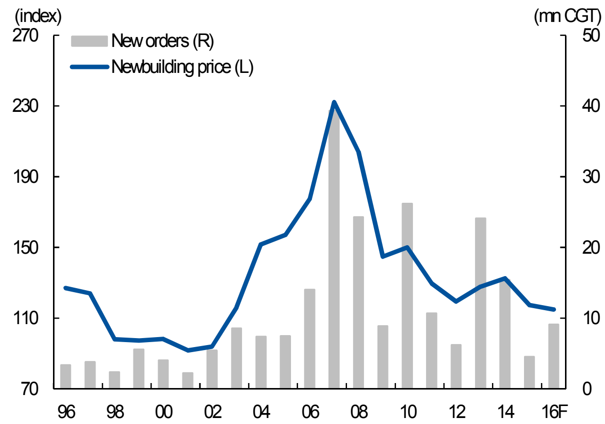
Source: Daewoo Securities Research

Figure 40. HRCI & CCFI



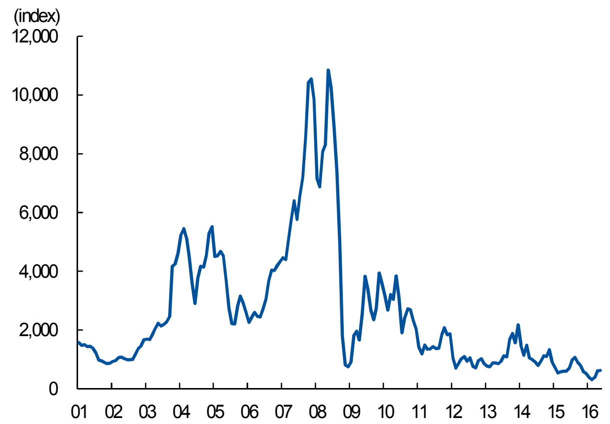
Source: Daewoo Securities Research

Figure 41. Bulk carrier new orders and price trend



Source: Daewoo Securities Research

Figure 42. Baltic dry index



Source: Daewoo Securities Research

3. Excess supply to be depleted significantly in 2017

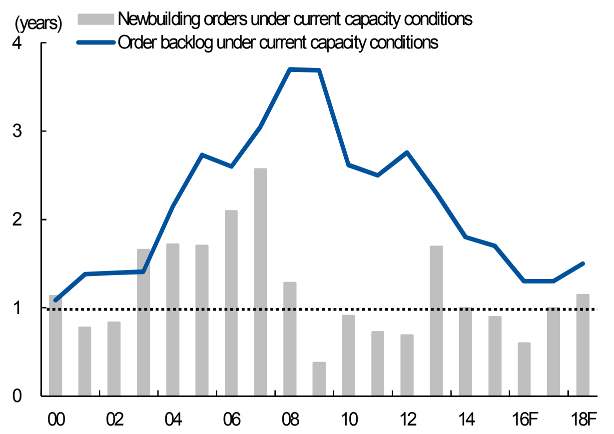
Tonnage supply/demand is estimated by subtracting trading volume growth and demolition growth from fleet growth.

For 2016, we expect global fleet and trading volume to grow 3.7% and 3.8% YoY, respectively. Meanwhile, demolitions, which typically climb in line with a rise in economic uncertainties, are likely to expand by more than 2.5%. As such, we estimate global oversupply will ease by 2.6% this year.

The current oversupply was triggered by massive orders placed in 2003-8. However, deliveries have decreased on the global financial crisis since peaking in 2010. In addition, fleet oversupply has already shown signs of easing thanks to increasing demolitions stemming from the economic sluggishness. As seen in <Figure 43>, new orders and order backlog relative to annual capacity have been decreasing on falling capacity.

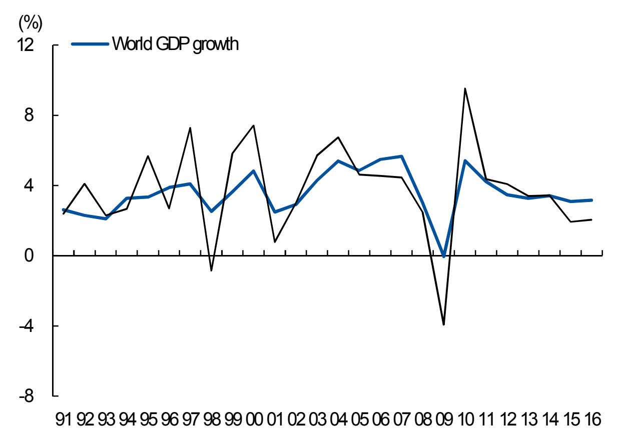
We believe excess supply will be depleted significantly in 2017. Once the supply/demand imbalance eases, the merchant vessel market is likely to become more sensitive to the business cycle. In addition, a significant number of shipbuilders are expected to undergo restructuring. As such, we expect the shipbuilding market to recover starting in 2018.

Figure 43. Order backlogs have plummeted



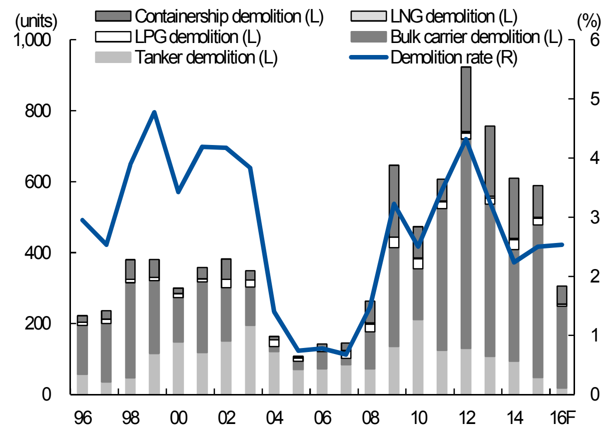
Source: Daewoo Securities Research

Figure 44. World GPD growth & trade volume growth



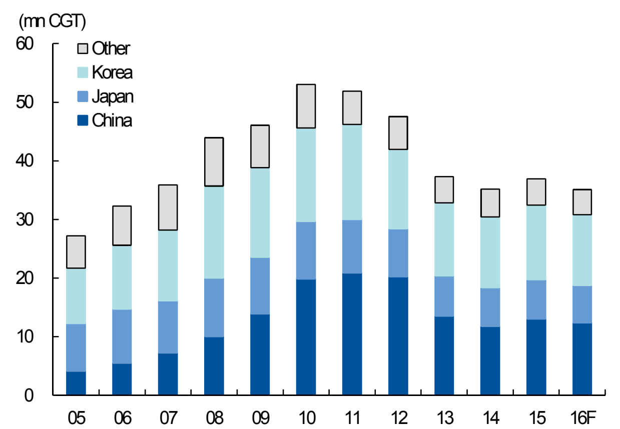
Source: Daewoo Securities Research

Figure 45. Global ship demolition by country



Source: Daewoo Securities Research

Figure 46. Global ship deliveries by country



Source: Daewoo Securities Research

IV. Offshore platform outlook: Oil recovery is key

1. Falling oil prices weighing on big oil companies

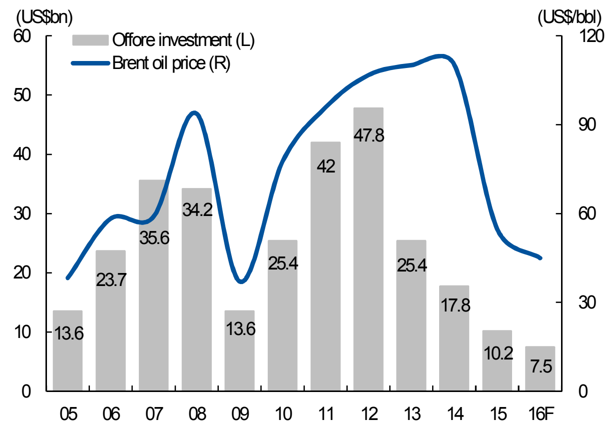
The beleaguered offshore platform market looks unlikely to pick up in the near term, given falling oil prices. Faced with declining profits, big oil companies have been forced to undergo restructuring, while financial investors are also seeking to recoup their investments. As such, capex in offshore platforms is likely to decline, affecting not only new projects, but also many small/mid-sized projects that have already started development.

In a low oil price environment, large oil companies are likely to cut their E&P spending to a minimum, focusing only on oil and gas wells that are highly efficient. We believe oil prices need to rise to at least US$60/bbl in order for oil companies to resume their spending. Simply put, the recovery of the offshore platform market will depend on the recovery of oil prices.

2. Biggest victim will be drilling facilities

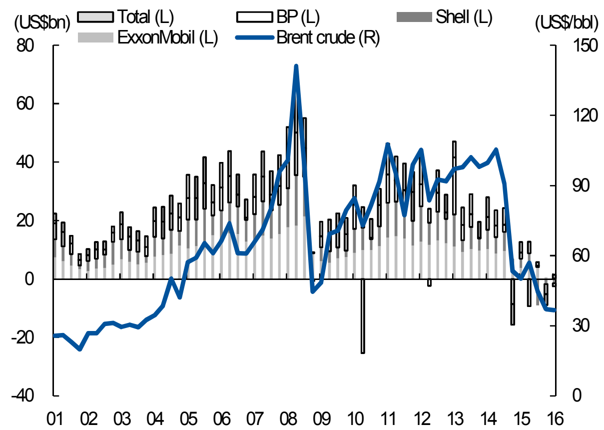
The utilization and day rate of offshore drilling facilities have plummeted. Some speculative orders have been canceled, with more cancellations on the way. As a result, major domestic shipbuilders handling large-scale drilling facilities are likely to come under intense pressure. As for offshore production facilities, we expect minimal capex, with most of it going to oil wells with high efficiency and gas wells with high demand.

Figure 47. Global offshore platform investments & oil price



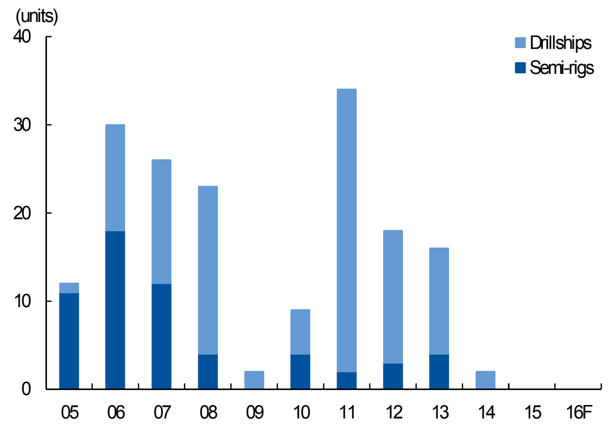
Source: Daewoo Securities Research

Figure 48. Oil price and quarterly OP of oil majors



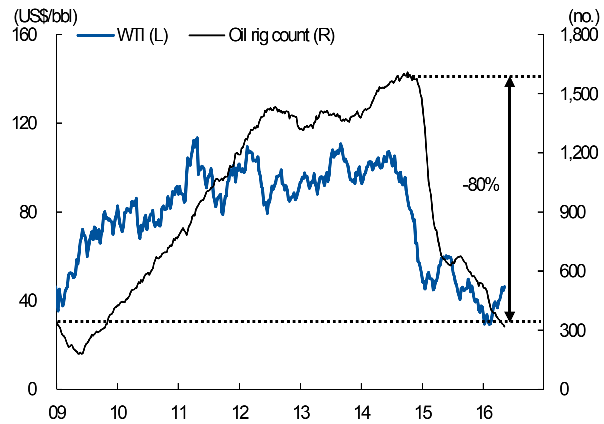
Source: Daewoo Securities Research

Figure 49. Orders of top three Korean shipbuilders



Source: Daewoo Securities Research

Figure 50. US oil rig count and WTI crude price



Source: Daewoo Securities Research

V. 2016 outlook for earnings and orders

1. Loss recognition nearly completed in 2015, diminishing uncertainties

While combined losses at the three largest shipbuilders totaled approximately W12tr in 2015, we do not foresee massive losses this year. Shipbuilders have already reflected potential massive losses with aggressive provisioning. While the number of projects has decreased, completion rates have increased. And with the normalization of merchant ship production, additional losses resulting from construction delays seem unlikely.

If oil prices stay low, however, shipbuilders could incur losses from delivery cancellations or delays. And subsidiary risks could emerge, as well. However, we see only a limited risk of further losses in 2016, given the low chance of additional production losses and the fact that losses would be deferred to 2017 and beyond.

2. Likely to swing to positive territory in 2016

We expect shipbuilders to swing to an operating profit in 2016, as: 1) the recognition of massive losses has reduced the likelihood of additional contingent losses, 2) the input of orders received during rising ship prices is likely to increase, 3) heavy plate and other raw material prices have fallen, and 4) restructuring should lead to greater profitability. For Hyundai Mipo Dockyard (HMD) and Hanjin Heavy Industries & Construction (HHIC), smaller exposure to F/X risks should enable them to benefit from the rising US$/W rate. Nevertheless, shipbuilders' margin improvement will likely be limited due to low order prices (taken in the past), revenue declines, and losses at offshore/onshore plants.

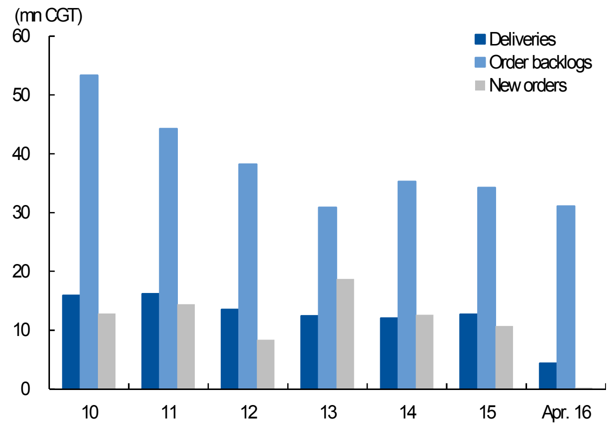
Shipbuilders' individual earnings forecasts are presented in Figures 53-58 and in the company section of this report.

3. 2016 orders to reach just half of 2015 level but pick up in 2017

In 1H16, shipbuilders have received few orders. Although orders are likely to recover in 2H, yearly orders are anticipated to be only half that of 2015. As seen in <Figure 49>, 2016 orders are projected to decline for the third straight year (2014-2016). However, orders are expected to pick up in 2017, assuming there is no global economic collapse on par with past crises. Except for during the 1970s oil shocks and the 2008 global crisis, shipbuilders have not seen orders contract by 50% or more for two straight years.

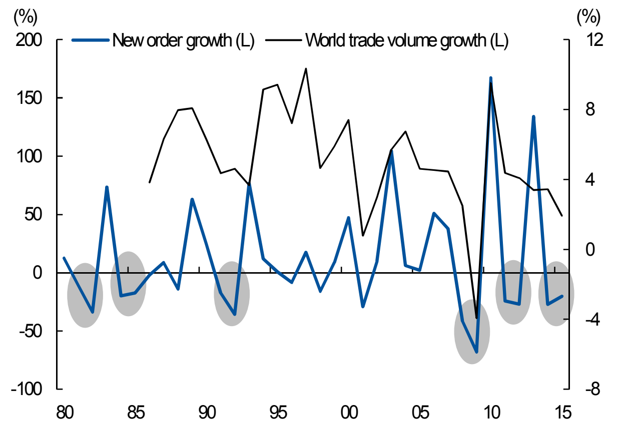
Shipbuilders' individual order performances are presented in Figures 59-62.

Figure 51. Korean shipbuilders' new orders, backlogs, and deliveries



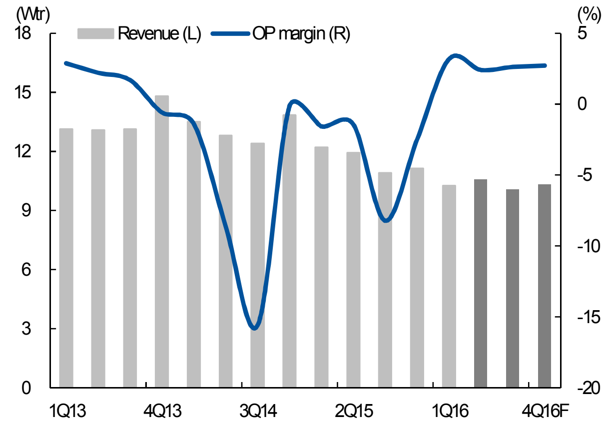
Source: Daewoo Securities Research

Figure 52. Global new order growth & trade volume growth



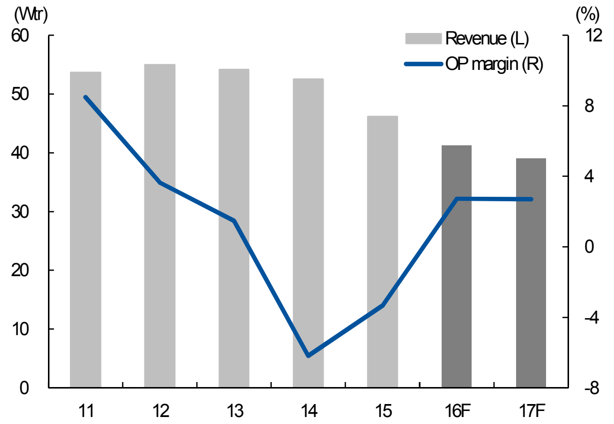
Source: Daewoo Securities Research

Figure 53. HHI's quarterly earnings



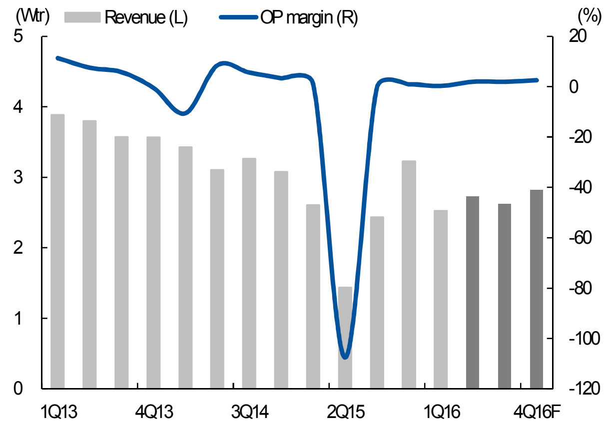
Source: Daewoo Securities Research

Figure 54. HHI's annual earnings



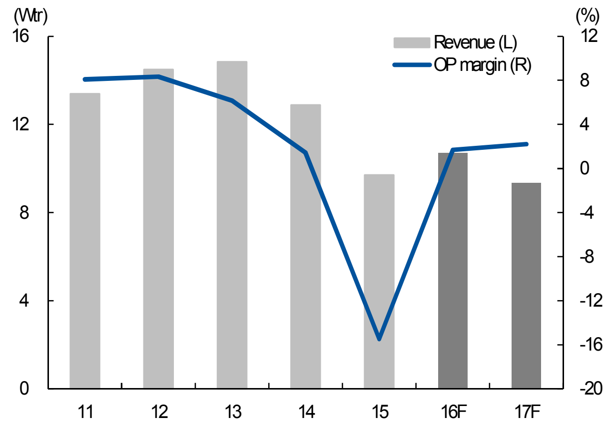
Source: Daewoo Securities Research

Figure 55. SHI's quarterly earnings



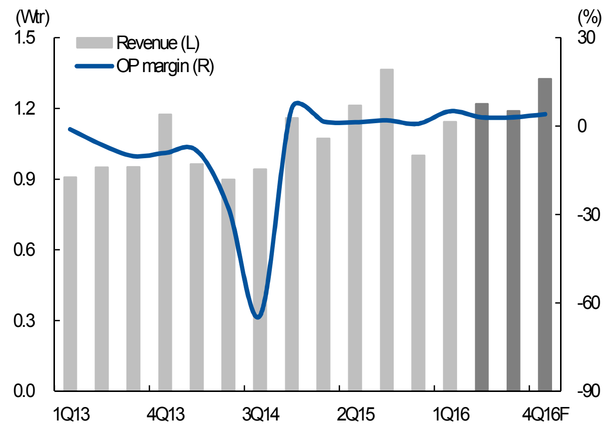
Source: Daewoo Securities Research

Figure 56. SHI's annual earnings



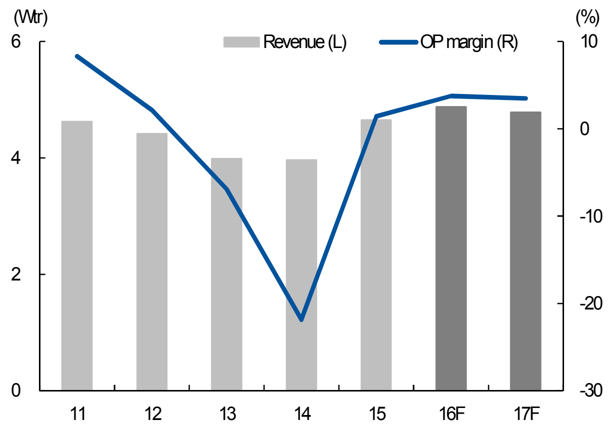
Source: Daewoo Securities Research

Figure 57. HMD's quarterly earnings



Source: Daewoo Securities Research

Figure 58. HMD's annual earnings



Source: Daewoo Securities Research

4. Order & backlog contraction → Low-priced orders → Poor 2017 earnings

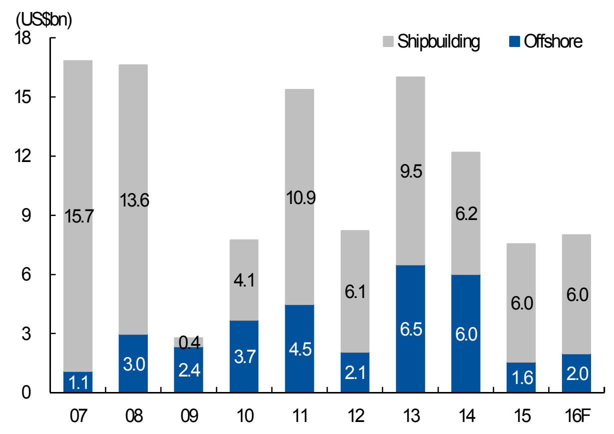
For 2016, we expect Korean shipbuilders' orders to decline YoY. Merchant vessel orders will likely decline by around 50% YoY, while offshore plant orders should hinge on oil prices. If oil prices rise to US$60, orders will likely increase YoY.

For the three major Korean shipbuilders, we project merchant vessel orders at around US$14bn (US$6bn for HHI and US$4bn for both SHI and DSME). Orders for flagship vessels—tankers, gas carriers (LNGC, VLEC, LPGC, etc.), and containerships—will likely decline YoY.

Of note, it is difficult to forecast offshore plant orders, as orders fluctuate sharply depending on oil prices. There has been just one large-scale offshore plant order in the past two years, and in light of falling oil prices, orders could remain weak. Orders are likely to be placed for production facilities, such as FLNG, FPSO, and FPU, while no orders are expected for drilling facilities, including drillships. If oil prices rise to US$60, major oil production companies will likely move to place orders.

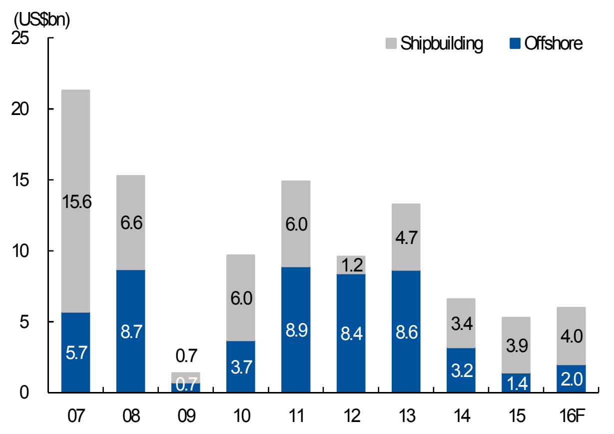
HMD is also likely to struggle with weak orders. Although HMD won massive orders for LPG carriers in 2015, the company is likely to see LPG carrier orders decrease in 2016. Meanwhile, it should receive significant orders for small-sized containerships and product carriers. In addition, the company will likely win orders for pure car/truck carrier (PCTC) vessels and bulk carriers.

Figure 59. HHI's new order breakdown



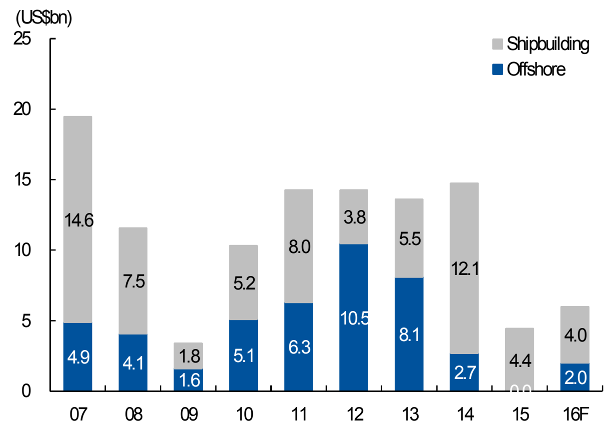
Source: Daewoo Securities Research

Figure 60. SHI's new order breakdown



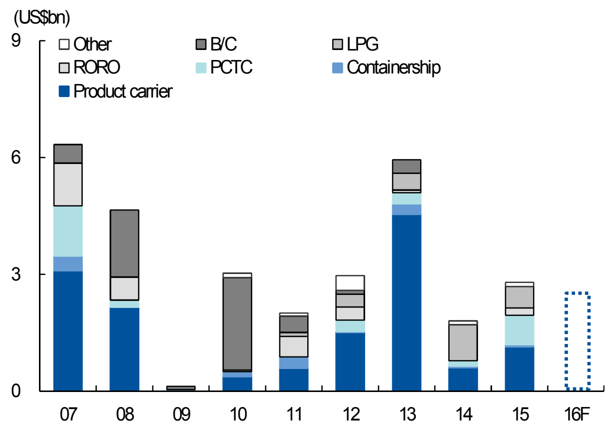
Source: Daewoo Securities Research

Figure 61. DSME's new order breakdown



Source: Daewoo Securities Research

Figure 62. HMD's new order breakdown



Source: Daewoo Securities Research

VI. Investment strategy & valuation

1. Selectively overweight potential survivors

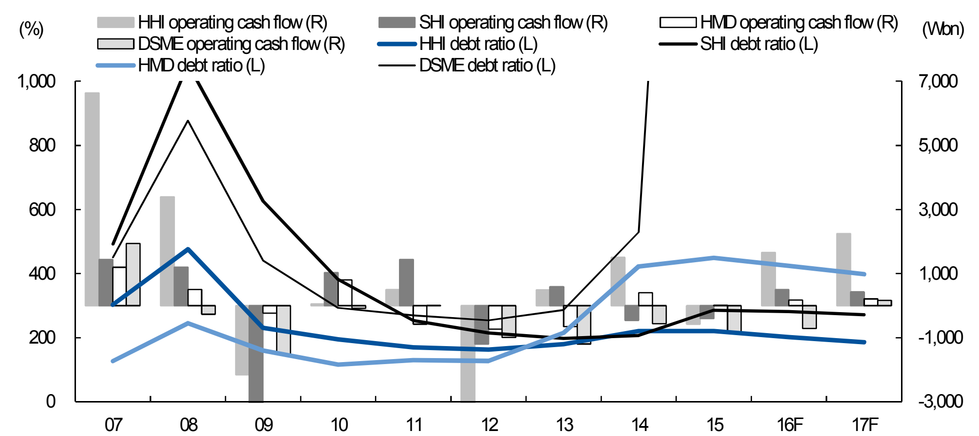
We believe 2016 will be the most challenging period for shipbuilders since the oil shocks of the 1970s, as persistent low oil prices and the global slump have led to a supply glut, weak order backlogs, and deteriorating financials. In these circumstances, shipbuilders are fighting to survive. While we remain Overweight on the shipbuilding sector, we advise investors to selectively overweight stocks most likely to benefit from quick industry realignment.

In 1H, shipbuilding stocks have depended on the easing of uncertainties. In 2H, only the few companies with the highest likelihood of surviving industry realignment will gain traction, in our view. Although global trading is still sluggish, fleet oversupply is anticipated to ease starting in 2017. Production capacity is likely to decrease to pre-2005 levels following industry restructuring. Given this, we expect survivors to turn around quickly in 2017.

2. Lower target P/B to 0.8x

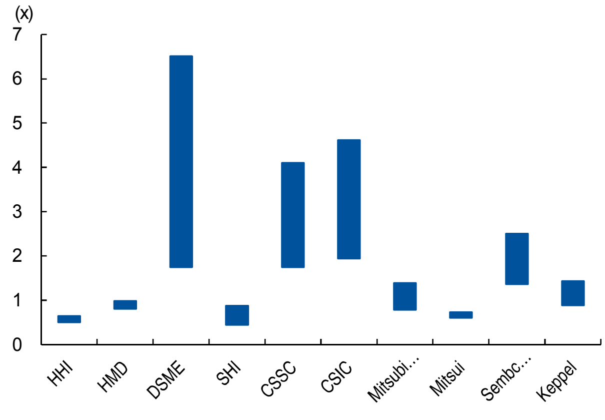
The shipbuilding industry's ongoing restructuring over the last two years has eased uncertainties significantly. Restructuring should continue for the time being. As earnings deterioration seems inevitable given the market slump, we lowered our target P/B for shipbuilders that are likely to survive by 20% from 1.0x to 0.8x. Considering that earnings are anticipated to decline through 2018, our valuation is also based on 2018F earnings.

Figure 63. Korean shipbuilders' debt ratio & operating cash flow trends



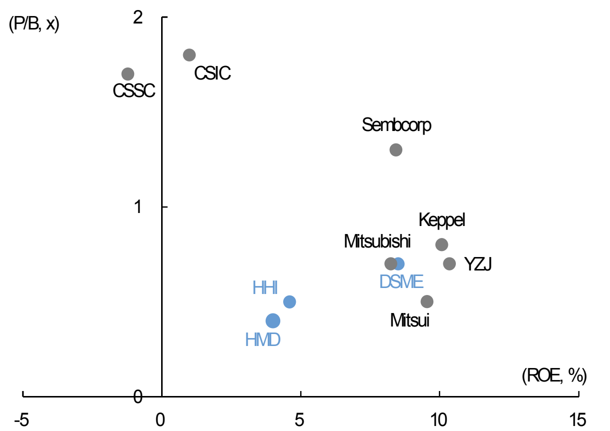
Source: Daewoo Securities Research

Figure 64. P/B changes over the past year



Source: Daewoo Securities Research

Figure 65. P/B-ROE comparison for global peer group (2016F)



Source: Daewoo Securities Research

3. Top picks: HHI and HMD

For 2016, we select HHI (09540 KS/Buy/TP: W142,000) and HMD (010620 KS/Buy/TP: W100,000) as our top picks for the shipbuilding sector.

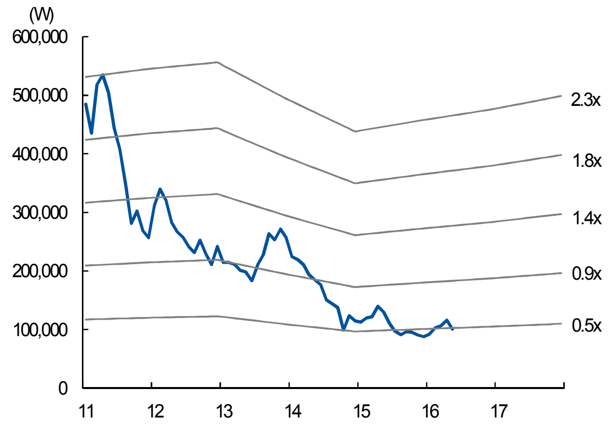
Given the difficulties facing SHI and DSME, HHI is anticipated to perform relatively well, aided by strong competitiveness in merchant vessels.

Thanks to aggressive preemptive efforts at recovery (e.g., asset sales, recognition of losses), HHI now boasts the most stable financials in the sector. Although the offshore/onshore plant business might incur additional losses, we expect HHI to generate stable earnings on the back of 1) the merchant vessel unit's turning to positive, 2) robust earnings at subsidiary Hyundai Oil Bank, and 3) gains in other business units. Although sluggish orders could dampen cash flow, HHI is our favorite among the three big players thanks to its disposable assets and the potential IPOs of subsidiaries.

Among smaller shipbuilders, HMD possesses the strongest global competitiveness. Although the market slump should inevitably cause orders to decline, the company is likely to benefit the most from global shipbuilding industry restructuring. Earnings are turning around, generating stable cash flow. We believe HMD will survive the fierce competition ahead, and expect the stock to reach a P/B of 1.0x the most quickly in the sector.

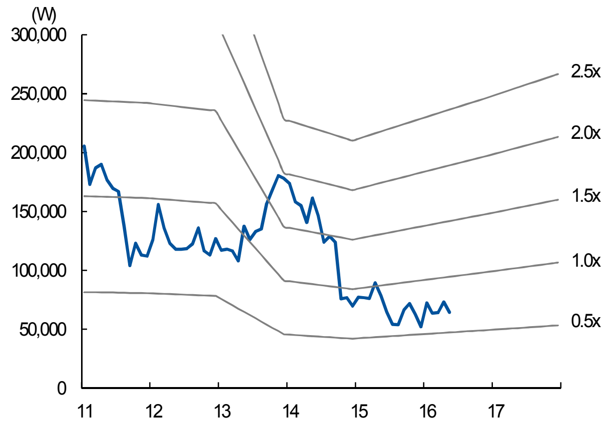
As for Chinese competitors, we expect large Chinese shipbuilders' competitiveness to weaken in 2016 amid sweeping restructuring in the country. In addition, orders for specialty ships are likely to outstrip those for bulk carriers in 2016, benefitting HMD.

Figure 66. HHI's P/B band



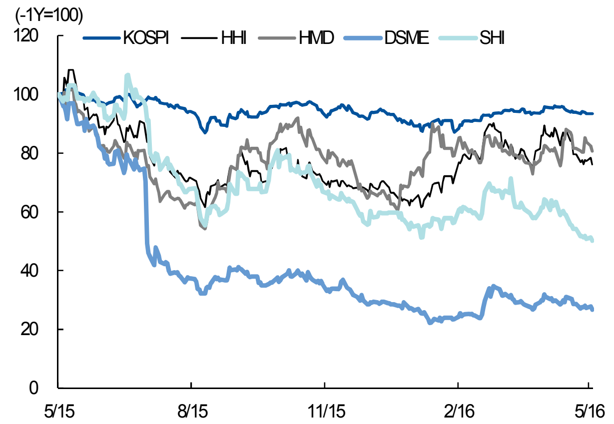
Source: Daewoo Securities Research

Figure 67. HMD's P/B band



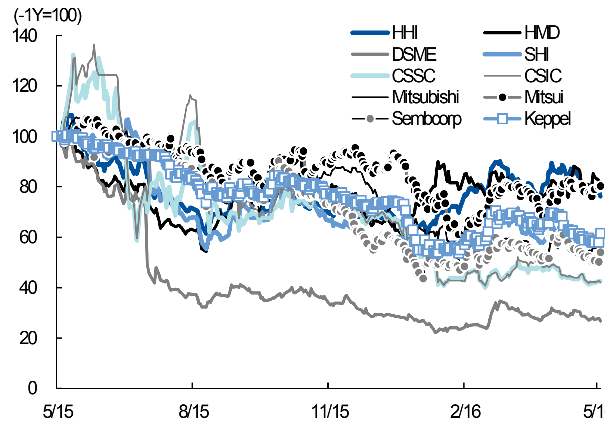
Source: Daewoo Securities Research

Figure 68. Relative share performances of Korean shipbuilders



Source: Daewoo Securities Research

Figure 69. Relative share performances of major shipbuilders



Source: Daewoo Securities Research

Table 5. Global peer valuation table

		HHI	SHI	DSME	HMD	CSSC	CSIC	Yangzijiang	Mitsu-bishi	Mitsui	Keppel	Semb-corp	Average
Market cap (Wbn)		7,638	2,106	1,293	1,286	5,399	19,501	2,957	15,222	1,588	8,393	2,893	-
Revenue (Wbn)	2015	46,373	9,656	13,214	4,661	5,843	10,672	3,211	42,691	8,619	9,061	3,946	-
	2016F	42,133	10,285	13,014	4,484	5,584	11,637	2,766	48,270	8,113	7,114	3,386	-
	2017F	41,192	9,437	12,114	4,294	4,879	12,117	2,858	50,536	8,414	7,069	3,177	-
OP (Wbn)	2015	-1,134	-1,464	-4,543	83	-98	-468	625	3,121	126	1,354	331	-
	2016F	944	143	151	167	-71	-120	528	3,643	330	1,027	289	-
	2017F	1,151	193	314	189	9	4	494	3,911	327	1,018	297	-
OP margin (%)	2015	-2.4	-15.2	-34.4	1.8	-1.7	-4.4	19.4	7.3	1.5	14.9	8.4	-0.4
	2016F	2.2	1.4	1.2	3.7	-1.3	-1.0	19.1	7.5	4.1	14.4	8.5	5.4
	2017F	2.8	2.0	2.6	4.4	0.2	0.0	17.3	7.7	3.9	14.4	9.4	5.9
Net profit (Wbn)	2015	-920	-1,146	-4,147	62	-64	-	560	1,013	73	1,193	205	-
	2016F	603	98	8	133	-38	102	411	1,564	222	987	191	-
	2017F	767	142	145	154	26	225	404	1,754	192	982	186	-
EV/EBITDA (x)	2015	-	-	-	1.6	49.1	-	3.0	5.2	13.0	9.5	13.3	13.6
	2016F	8.5	13.4	22.4	1.0	35.9	49.3	3.4	4.9	6.5	11.6	13.8	15.5
	2017F	7.7	12.6	15.7	0.9	25.2	32.4	3.5	4.6	6.5	11.6	13.4	12.2
P/E (x)	2015	-	-	-	20.4	207.5	182.8	5.5	13.9	20.6	6.9	14.0	59.0
	2016F	12.3	20.7	77.3	9.5	71.9	82.4	7.0	9.7	6.6	8.3	15.0	29.2
	2017F	9.6	14.1	8.4	8.2	143.9	48.3	7.3	8.6	7.7	8.4	15.4	25.5
P/B (x)	2015	0.5	0.5	0.8	0.7	1.7	1.8	0.7	0.8	0.6	0.9	1.1	0.9
	2016F	0.5	0.5	1.4	0.7	1.7	1.8	0.7	0.7	0.5	0.8	1.3	1.0
	2017F	0.5	0.4	1.2	0.6	1.7	1.8	0.7	0.7	0.5	0.8	1.2	0.9
P/S (x)	2015	0.2	0.2	0.1	0.3	0.9	1.8	1.0	0.3	0.2	0.9	0.7	0.6
	2016F	0.2	0.2	0.1	0.3	1.0	1.7	1.1	0.3	0.2	1.2	0.9	0.6
	2017F	0.2	0.2	0.1	0.3	1.1	1.6	1.0	0.3	0.2	1.2	0.9	0.6
ROE (%)	2015	-6.3	-22.7	-123.4	3.3	-2.1	-2.9	14.0	5.8	2.7	13.4	7.6	-10.1
	2016F	4.3	2.4	0.3	7.5	-1.2	1.0	10.3	8.2	9.6	10.1	8.4	5.5
	2017F	5.3	3.4	11.1	8.5	0.8	2.1	9.3	8.7	7.4	9.3	7.5	6.7
ROA (%)	2015	-1.9	-7.0	-21.5	0.7	0.7	-0.1	7.3	1.8	-	4.7	2.9	-1.2
	2016F	1.5	0.5	0.2	1.7	0.3	0.3	6.0	2.9	-	4.0	2.8	2.0
	2017F	1.9	0.9	1.4	2.0	0.4	0.5	5.8	3.0	-	4.0	2.7	2.3
EPS (W)	2015	-12,574	-5,050	-17,816	3,145	0.1	0.0	0.8	29.9	8.5	0.8	0.1	-
	2016F	8,194	441	61	6,749	0.3	0.1	0.6	43.0	26.6	0.6	0.1	-
	2017F	10,467	649	561	7,826	0.2	0.1	0.6	48.2	22.9	0.6	0.1	-
BPS (W)	2015	202,332	19,996	5,963	92,541	12.4	3.3	5.9	549	297	6.1	1.4	-
	2016F	196,523	20,242	3,448	91,981	12.6	3.2	6.1	573	321	6.5	1.3	-
	2017F	206,232	20,544	4,106	101,794	12.6	3.3	6.4	609	346	6.8	1.4	-

Source: Bloomberg, Daewoo research

Hyundai Heavy Industries (009540 KS)

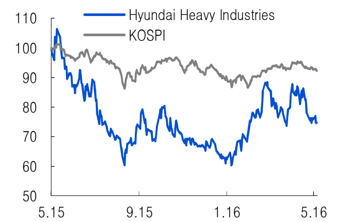
Growing opportunities amid market slump

Shipbuilding

(Maintain)	Buy
Target Price (12M, W)	142,000
Share Price (05/18/16, W)	100,500
Expected Return	41%

OP (16F, Wbn)	1,123
Consensus OP (16F, Wbn)	996
EPS Growth (16F, %)	-
Market EPS Growth (16F, %)	16.9
P/E (16F, x)	11.7
Market P/E (16F, x)	10.6
KOSPI	1,956.73
Market Cap (Wbn)	7,638
Shares Outstanding (mn)	76
Free Float (%)	64.5
Foreign Ownership (%)	13.4
Beta (12M)	1.54
52-Week Low	81,200
52-Week High	143,000

(%)	1M	6M	12M
Absolute	-11.1	11.4	-22.1
Relative	-8.7	11.8	-15.8



Competitors face growing challenges

Hyundai Heavy Industries (HHI) stands to benefit from the business and financial hardships of its biggest rivals, SHI and DSME. For those shipbuilders, restructuring pressures will likely outweigh expectations for further financial aid from creditors. In addition, they will likely have to scale down their capacities. Meanwhile, HHI displayed superior order performance in the merchant vessel area in 2015 and is expected to maintain a competitive edge through 2016. The company has improved its financial stability through preemptive restructuring and has diversified its business portfolio beyond shipbuilding.

Businesses to normalize, but top line to contract

Uncertainties that have weighed on HHI should mostly dissipate in 2016. This year, we expect HHI to wrap up its first restructuring in 40 years, end the two-year loss streak, and embark on business normalization. Although the on/off-shore plant segment may incur further losses for a while, it is unlikely to book large losses.

In the drilling rig segment (where order cancellation risks were high), HHI has no order backlog, except for one drillship scheduled for delivery in 1H16. Tight production schedules have eased, shipyards now have some extra space, and complicated, high-cost production processes have mostly been completed (over 90%). Merchant ship earnings have already turned to profit on a consolidated basis, and other businesses (except for construction machinery) are also likely to turn around in 2Q.

Refining margins, which narrowed amid falling oil prices, should increase YoY if oil does not slide further. The firm is making self-rescue efforts to restore its financial health, including large-scale disposal of stocks and other assets. And the operating results of subsidiary shipbuilders have all normalized on the back of productivity growth.

Looking ahead, the firm’s performance will likely be dictated by oil prices and economic recovery. Low oil prices have caused delays to offshore plant construction projects, and shipbuilding orders have been postponed amid the economic slowdown.

Maintain Buy with TP of W142,000

We reiterate our Buy rating and a target price of W142,000. Uncertainty is fading and earnings are stabilizing, which should reduce the firm’s valuation discount. Despite the prolonged economic slowdown, the firm should survive ongoing restructuring better than its competitors, thanks to its relatively strong competitive edge and stable financial position. The industry-wide restructuring is anticipated to continue into 2017, after which the firm will likely be re-rated.

FY (Dec.)	12/13	12/14	12/15	12/16F	12/17F	12/18F
Revenue (Wbn)	54,188	52,582	46,232	41,252	39,065	41,019
OP (Wbn)	802	-3,249	-1,540	1,123	1,055	1,190
OP margin (%)	1.5	-6.2	-3.3	2.7	2.7	2.9
NP (Wbn)	279	-1,769	-1,350	651	614	762
EPS (W)	3,667	-23,279	-17,762	8,571	8,079	10,031
ROE (%)	1.6	-10.9	-9.3	4.6	4.2	5.0
P/E (x)	70.1	-	-	11.7	12.4	10.0
P/B (x)	1.0	0.5	0.5	0.5	0.5	0.5

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

Hyundai Heavy Industries (009540 KS/Buy/TP: W142,000)

Comprehensive Income Statement (Summarized)

(Wbn)	12/15	12/16F	12/17F	12/18F
Revenue	**46,232**	**41,252**	**39,065**	**41,019**
Cost of Sales	**44,682**	**37,778**	**35,862**	**37,573**
Gross Profit	**1,550**	**3,474**	**3,203**	**3,446**
SG&A Expenses	**3,090**	**2,351**	**2,149**	**2,256**
Operating Profit (Adj)	**-1,540**	**1,123**	**1,055**	**1,190**
Operating Profit	**-1,540**	**1,123**	**1,055**	**1,190**
Non-Operating Profit	**-301**	**-118**	**-151**	**-68**
Net Financial Income	-147	-139	-122	-109
Net Gain from Inv in Associates	-56	0	0	0
Pretax Profit	-1,841	1,005	904	1,122
Income Tax	-478	241	221	275
Profit from Continuing Operations	-1,363	764	682	847
Profit from Discontinued Operations	0	0	0	0
Net Profit	**-1,363**	**764**	**682**	**847**
Controlling Interests	-1,350	651	614	762
Non-Controlling Interests	-13	112	68	85
Total Comprehensive Profit	**-1,900**	**764**	**682**	**847**
Controlling Interests	-1,854	745	666	826
Non-Controlling Interests	-46	19	17	21
EBITDA	-472	2,125	2,004	2,092
FCF (Free Cash Flow)	-1,855	1,342	1,805	660
EBITDA Margin (%)	-1.0	5.2	5.1	5.1
Operating Profit Margin (%)	-3.3	2.7	2.7	2.9
Net Profit Margin (%)	-2.9	1.6	1.6	1.9

Statement of Financial Condition (Summarized)

(Wbn)	12/15	12/16F	12/17F	12/18F
Current Assets	**27,176**	**27,382**	**27,370**	**28,082**
Cash and Cash Equivalents	3,105	3,574	3,857	3,439
AR & Other Receivables	4,757	4,176	3,955	4,315
Inventories	4,492	4,688	4,490	4,715
Other Current Assets	14,822	14,944	15,068	15,613
Non-Current Assets	**22,557**	**21,705**	**21,134**	**20,765**
Investments in Associates	270	275	281	295
Property, Plant and Equipment	16,320	15,732	15,315	14,935
Intangible Assets	2,140	2,046	1,964	1,891
Total Assets	**49,733**	**49,087**	**48,504**	**48,847**
Current Liabilities	**23,061**	**21,996**	**21,742**	**21,658**
AP & Other Payables	4,416	4,267	4,338	4,439
Short-Term Financial Liabilities	10,083	9,596	9,109	0
Other Current Liabilities	8,562	8,133	8,295	17,219
Non-Current Liabilities	**11,173**	**10,828**	**9,817**	**9,397**
Long-Term Financial Liabilities	9,518	9,218	8,218	0
Other Non-Current Liabilities	1,655	1,610	1,599	9,397
Total Liabilities	**34,234**	**32,824**	**31,559**	**31,055**
Controlling Interests	**13,736**	**14,388**	**15,002**	**15,764**
Capital Stock	380	380	380	380
Capital Surplus	1,125	1,125	1,125	1,125
Retained Earnings	12,819	13,470	14,084	14,846
Non-Controlling Interests	**1,763**	**1,875**	**1,943**	**2,028**
Stockholders' Equity	**15,499**	**16,263**	**16,945**	**17,792**

Cash Flows (Summarized)

(Wbn)	**12/15**	**12/16F**	**12/17F**	**12/18F**
Cash Flows from Op Activities	-574	1,662	2,255	1,110
Net Profit	-1,363	764	682	847
Non-Cash Income and Expense	1,736	1,515	1,276	1,199
Depreciation	962	908	867	829
Amortization	107	94	83	73
Others	667	513	326	297
Chg in Working Capital	-916	-334	543	-648
Chg in AR & Other Receivables	-628	693	190	-332
Chg in Inventories	1,266	-195	197	-225
Chg in AP & Other Payables	-2,480	-149	57	87
Income Tax Paid	**0**	**-241**	**-221**	**-275**
Cash Flows from Inv Activities	-147	-421	-499	-571
Chg in PP&E	-1,235	-320	-450	-450
Chg in Intangible Assets	-28	0	0	0
Chg in Financial Assets	1,300	149	51	-121
Others	**-184**	**-250**	**-100**	**0**
Cash Flows from Fin Activities	594	-798	-1,497	-944
Chg in Financial Liabilities	-427	-787	-1,487	-934
Chg in Equity	16	0	0	0
Dividends Paid	0	0	0	0
Others	**1,005**	**-11**	**-10**	**-10**
Increase (Decrease) in Cash	-124	469	284	-418
Beginning Balance	3,229	3,105	3,574	3,857
Ending Balance	**3,105**	**3,574**	**3,857**	**3,439**

Forecasts/Valuations (Summarized)

	12/15	**12/16F**	**12/17F**	**12/18F**
P/E (x)	-	11.7	12.4	10.0
P/CF (x)	17.9	3.4	3.9	3.7
P/B (x)	0.5	0.5	0.5	0.5
EV/EBITDA (x)	-	9.2	8.9	8.3
EPS (W)	-17,762	8,571	8,079	10,031
CFPS (W)	4,901	29,981	25,769	26,915
BPS (W)	193,461	202,032	210,111	220,141
DPS (W)	0	0	0	0
Payout ratio (%)	0.0	0.0	0.0	0.0
Dividend Yield (%)	0.0	0.0	0.0	0.0
Revenue Growth (%)	-12.1	-10.8	-5.3	5.0
EBITDA Growth (%)	-	-	-5.7	4.4
Operating Profit Growth (%)	-	-	-6.1	12.8
EPS Growth (%)	-	-	-5.7	24.2
Accounts Receivable Turnover (x)	11.1	10.5	11.2	11.5
Inventory Turnover (x)	9.0	9.0	8.5	8.9
Accounts Payable Turnover (x)	13.3	13.0	12.5	12.8
ROA (%)	-2.6	1.5	1.4	1.7
ROE (%)	-9.3	4.6	4.2	5.0
ROIC (%)	-4.5	3.5	3.3	3.9
Liability to Equity Ratio (%)	220.9	201.8	186.2	174.5
Current Ratio (%)	117.8	124.5	125.9	129.7
Net Debt to Equity Ratio (%)	73.3	62.0	48.9	43.3
Interest Coverage Ratio (x)	-6.8	5.1	5.1	6.2

Source: Company data, Daewoo Securities Research estimates

Hyundai Mipo Dockyard (010620 KS)

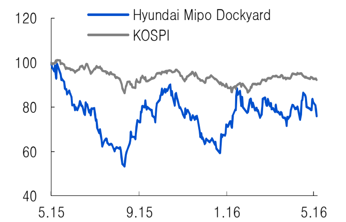
Beneficiary of ongoing restructuring

Shipbuilding

(Maintain)	**Buy**
Target Price (12M, W)	**100,000**
Share Price (05/18/16, W)	64,300
Expected Return	56%

OP (16F, Wbn)	183
Consensus OP (16F, Wbn)	187
EPS Growth (16F, %)	289.8
Market EPS Growth (16F, %)	16.9
P/E (16F, x)	8.6
Market P/E (16F, x)	10.6
KOSPI	1,956.73
Market Cap (Wbn)	1,286
Shares Outstanding (mn)	20
Free Float (%)	56.6
Foreign Ownership (%)	15.4
Beta (12M)	1.39
52-Week Low	45,100
52-Week High	84,300

(%)	1M	6M	12M
Absolute	-4.0	-1.2	-21.1
Relative	-1.5	-0.9	-14.8



The biggest beneficiary of global shipbuilding restructuring

Hyundai Mipo Dockyard (HMD) is without a doubt the biggest beneficiary of the global shipbuilding downturn and the resultant massive restructuring. Amid the prolonged slowdown, shipbuilding orders and ship financing have been concentrated on the select few best equipped to survive restructuring. The discrepancy is particularly pronounced in the high value-added segment. In 2015, HMD enjoyed a stable order stream despite the relative weakness of the small/medium-sized shipbuilding market. Restructuring is projected to continue this year, with the divergence among shipbuilders' performances likely to deepen further.

Valuation re-rating expected on production & earnings normalization

Delays to HMD's shipbuilding schedule have mostly been resolved through capacity expansions at subcontractors and productivity improvements. Going forward, operating results are projected to improve gradually, on the back of the write-back of provisions for construction losses, favorable F/X rates, and the input of high-priced vessels. Hyundai-Vinashin Shipyard (Vietnamese subsidiary) should also experience growth driven by similar positive factors.

Despite the dismal shipbuilding market, HMD keeps an order backlog of roughly 1.5 years thanks to stable order-taking this year. Indeed, although the product carrier (PC; key business) market deteriorated, the company has managed to take ample orders for LPG carriers and specialty ships (e.g., PCTC, RORO). Given the strengthening won and the company's global competitiveness, HMD's order performance is likely to be strong relative to competitors. Still, amid the global slump, order volume is anticipated to decrease YoY. Competitors are expected to undergo painful restructuring.

We expect HMD's earnings to improve gradually, aided by normalization of production, a higher US$/W rate, an increased input of PC orders received during rising ship prices, and better subsidiary productivity. Thanks to its relatively low exposure to F/X risks, the company should benefit from a rising US$/W rate more than competitors. Furthermore, in light of improvement in the production process, we expect an additional write-back of provisions set aside last year.

Retain Buy call with TP of W100,000

We reiterate a Buy rating with a target price of W100,000. Expectations for earnings momentum are mounting amid production normalization and healthy 1Q results. We retain our Buy stance, as our outlook on earnings and market conditions remains unchanged. Our target price, which is based on a P/B of 1.0x and 2016F BPS of W99,648, reflects the normalization of the company's business management.

In spite of the gloomy shipbuilding market and massive restructuring, HMD is attracting attention from shippers. Indeed, the company's market share is expanding even amid the market slump. And unlike large domestic shipbuilders, the company has no offshore plant business, and is thus free of related uncertainties. Considering its strengthening global market status, the stock appears deeply undervalued even considering the tepid commercial ship market.

FY (Dec.)	12/13	12/14	12/15	12/16F	12/17F	12/18F
Revenue (Wbn)	3,986	3,967	4,652	4,880	4,783	5,022
OP (Wbn)	-275	-868	67	183	167	176
OP margin (%)	-6.9	-21.9	1.4	3.8	3.5	3.5
NP (Wbn)	-238	-633	38	149	147	155
EPS (W)	-11,889	-31,642	1,910	7,444	7,369	7,765
ROE (%)	-7.6	-25.9	2.2	8.5	7.8	7.6
P/E (x)	-	-	27.3	8.6	8.7	8.3
P/B (x)	1.1	0.8	0.6	0.7	0.7	0.6

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

Hyundai Mipo Dockyard (010620 KS/Buy/TP: W100,000)

Comprehensive Income Statement (Summarized)

(Wbn)	12/15	12/16F	12/17F	12/18F
Revenue	**4,652**	**4,880**	**4,783**	**5,022**
Cost of Sales	**4,246**	**4,356**	**4,281**	**4,495**
Gross Profit	**406**	**524**	**502**	**527**
SG&A Expenses	**340**	**342**	**335**	**352**
Operating Profit (Adj)	**67**	**183**	**167**	**176**
Operating Profit	**67**	**183**	**167**	**176**
Non-Operating Profit	**-17**	**23**	**32**	**33**
Net Financial Income	-12	5	8	9
Net Gain from Inv in Associates	1	0	0	0
Pretax Profit	50	206	199	209
Income Tax	24	62	56	59
Profit from Continuing Operations	26	145	143	151
Profit from Discontinued Operations	0	0	0	0
Net Profit	**26**	**145**	**143**	**151**
Controlling Interests	38	149	147	155
Non-Controlling Interests	-13	-4	-4	-5
Total Comprehensive Profit	**-145**	**145**	**143**	**151**
Controlling Interests	-132	132	130	137
Non-Controlling Interests	-13	13	13	14
EBITDA	134	248	229	232
FCF (Free Cash Flow)	-1,249	79	129	190
EBITDA Margin (%)	2.9	5.1	4.8	4.6
Operating Profit Margin (%)	1.4	3.8	3.5	3.5
Net Profit Margin (%)	0.8	3.1	3.1	3.1

Statement of Financial Condition (Summarized)

(Wbn)	12/15	12/16F	12/17F	12/18F
Current Assets	**6,854**	**6,873**	**6,985**	**7,130**
Cash and Cash Equivalents	657	547	566	426
AR & Other Receivables	356	411	415	435
Inventories	255	261	266	271
Other Current Assets	5,586	5,654	5,738	5,998
Non-Current Assets	**2,584**	**2,620**	**2,581**	**2,555**
Investments in Associates	12	13	13	13
Property, Plant and Equipment	836	813	783	729
Intangible Assets	289	287	285	284
Total Assets	**9,438**	**9,493**	**9,566**	**9,685**
Current Liabilities	**5,618**	**5,577**	**5,556**	**5,551**
AP & Other Payables	483	501	518	537
Short-Term Financial Liabilities	3,590	3,500	3,415	0
Other Current Liabilities	1,545	1,576	1,623	5,014
Non-Current Liabilities	**2,023**	**1,975**	**1,925**	**1,898**
Long-Term Financial Liabilities	1,959	1,909	1,859	0
Other Non-Current Liabilities	64	66	66	1,898
Total Liabilities	**7,641**	**7,552**	**7,481**	**7,449**
Controlling Interests	**1,675**	**1,824**	**1,971**	**2,126**
Capital Stock	100	100	100	100
Capital Surplus	83	83	83	83
Retained Earnings	1,243	1,392	1,539	1,694
Non-Controlling Interests	**122**	**117**	**113**	**109**
Stockholders' Equity	**1,797**	**1,941**	**2,084**	**2,235**

Cash Flows (Summarized)

(Wbn)	**12/15**	**12/16F**	**12/17F**	**12/18F**
Cash Flows from Op Activities	-1,213	119	159	190
Net Profit	26	145	143	151
Non-Cash Income and Expense	54	55	38	75
Depreciation	66	63	60	54
Amortization	2	2	2	2
Others	-14	-10	-24	19
Chg in Working Capital	-1,378	-36	15	4
Chg in AR & Other Receivables	191	-9	-7	-13
Chg in Inventories	37	-5	-5	-5
Chg in AP & Other Payables	-601	9	9	9
Income Tax Paid	**-8**	**-62**	**-56**	**-59**
Cash Flows from Inv Activities	-66	-88	-6	-226
Chg in PP&E	-34	-40	-30	0
Chg in Intangible Assets	1	0	0	0
Chg in Financial Assets	142	-103	-36	-246
Others	**-175**	**55**	**60**	**20**
Cash Flows from Fin Activities	1,218	-140	-135	-104
Chg in Financial Liabilities	64	-140	-135	-104
Chg in Equity	-3	0	0	0
Dividends Paid	0	0	0	0
Others	**1,157**	**0**	**0**	**0**
Increase (Decrease) in Cash	-59	-110	19	-140
Beginning Balance	716	657	547	566
Ending Balance	**657**	**547**	**566**	**426**

Forecasts/Valuations (Summarized)

	12/15	**12/16F**	**12/17F**	**12/18F**
P/E (x)	27.3	8.6	8.7	8.3
P/CF (x)	13.0	6.4	7.1	5.7
P/B (x)	0.6	0.7	0.7	0.6
EV/EBITDA (x)	13.5	8.0	7.7	6.8
EPS (W)	1,910	7,444	7,369	7,765
CFPS (W)	4,002	9,984	9,040	11,267
BPS (W)	84,070	91,513	98,882	106,647
DPS (W)	0	0	0	0
Payout ratio (%)	0.0	0.0	0.0	0.0
Dividend Yield (%)	0.0	0.0	0.0	0.0
Revenue Growth (%)	17.3	4.9	-2.0	5.0
EBITDA Growth (%)	-	85.1	-7.7	1.3
Operating Profit Growth (%)	-	173.1	-8.7	5.4
EPS Growth (%)	-	289.7	-1.0	5.4
Accounts Receivable Turnover (x)	28.2	20.3	19.2	19.4
Inventory Turnover (x)	17.1	18.9	18.2	18.7
Accounts Payable Turnover (x)	15.2	15.0	14.3	14.6
ROA (%)	0.3	1.5	1.5	1.6
ROE (%)	2.2	8.5	7.8	7.6
ROIC (%)	3.2	11.6	11.0	12.2
Liability to Equity Ratio (%)	425.3	389.0	358.9	333.3
Current Ratio (%)	122.0	123.2	125.7	128.4
Net Debt to Equity Ratio (%)	35.7	29.3	17.8	8.6
Interest Coverage Ratio (x)	2.5	22.3	31.3	33.7

Source: Company data, Daewoo Securities Research estimates

Samsung Heavy Industries (010140 KS)

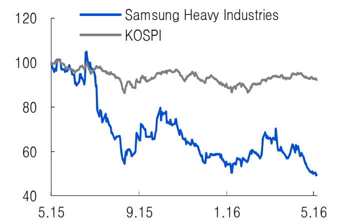
In need of liquidity injection

Shipbuilding

(Maintain)	Hold
Target Price (12M, W)	-
Share Price (05/18/16, W)	9,120
Expected Return	-

OP (16F, Wbn)	182
Consensus OP (16F, Wbn)	101
EPS Growth (16F, %)	-
Market EPS Growth (16F, %)	16.9
P/E (16F, x)	12.2
Market P/E (16F, x)	10.6
KOSPI	1,956.73
Market Cap (Wbn)	2,106
Shares Outstanding (mn)	231
Free Float (%)	64.7
Foreign Ownership (%)	14.5
Beta (12M)	2.05
52-Week Low	9,110
52-Week High	19,350

(%)	1M	6M	12M
Absolute	-17.1	-22.1	-48.5
Relative	-14.9	-21.8	-44.3



Weak order backlogs to depress earnings going forward

Samsung Heavy Industries (SHI) is expected to report stable quarterly earnings in 2016. The company mostly booked offshore plant losses in 2015, and progress in troubled projects and a decrease in new projects have improved productivity. Accordingly, the merchant vessel business has smoothly normalized.

Going forward, weakened order backlogs will likely weigh on the company. Over the past two years, SHI has received no offshore plant orders, and the already-received three FLNG orders were cancelled. In our view, offshore plant orders are unlikely to rebound in the foreseeable future as oil prices remain low. We might see a placement of some production equipment orders this year. However, SHI should face difficulties in landing the orders due to fierce competition.

Merchant vessel orders fell to a historic-low level this year, with backlog contracting to one and a half years. Newbuilding orders will likely remain in a slump for a while amid the prolonged slowdown in the global economy and intensifying competition. Shippers are either scaling down their order plans or pushing back order placements. Accordingly, the company should see its top line shrink in 2017.

Offshore plant risks could reemerge

If oil prices remain low going forward, offshore plant risks could emerge again. SHI has postponed the delivery of some drillships. If delivery is cancelled, the company will incur an additional financial burden, including inventory losses. With the slump in orders further weighing on the company's financials, a recovery in oil prices and in the global economy will be critical to future earnings.

Maintain Hold

We reaffirm our Hold rating, given rising uncertainties about liquidity. SHI's liquidity has dried up, as the firm did not receive any advances amid falling orders. A declining order backlog also suggests top-line contraction. The firm's self-rescue efforts will likely be insufficient to address these risks.

Offshore risks also persist. Drillship delivery schedules have been postponed, but there is a chance that orders will be cancelled. As a drillship is priced at around W600bn, a cancellation could cost the firm around W500bn/ship in uncollected receivables (in heavy-tail terms). In addition, the production facility business may also have to recognize additional losses.

FY (Dec.)	12/13	12/14	12/15	12/16F	12/17F	12/18F
Revenue (Wbn)	14,835	12,879	9,714	10,705	9,346	9,860
OP (Wbn)	914	183	-1,502	182	206	316
OP margin (%)	6.2	1.4	-15.5	1.7	2.2	3.2
NP (Wbn)	632	149	-1,205	172	206	257
EPS (W)	2,737	646	-5,218	746	893	1,113
ROE (%)	11.4	2.6	-24.7	4.0	4.6	5.4
P/E (x)	13.9	30.9	-	12.2	10.2	8.2
P/B (x)	1.4	0.7	0.5	0.4	0.4	0.4

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

Samsung Heavy Industries (010140 KS/Hold)

Comprehensive Income Statement (Summarized)

(Wbn)	12/15	12/16F	12/17F	12/18F
Revenue	**9,714**	**10,705**	**9,346**	**9,860**
Cost of Sales	**10,676**	**9,902**	**8,598**	**8,972**
Gross Profit	**-962**	**803**	**748**	**888**
SG&A Expenses	**540**	**621**	**542**	**572**
Operating Profit (Adj)	**-1,502**	**182**	**206**	**316**
Operating Profit	**-1,502**	**182**	**206**	**316**
Non-Operating Profit	**40**	**5**	**50**	**3**
Net Financial Income	-11	-5	1	4
Net Gain from Inv in Associates	-1	0	0	0
Pretax Profit	-1,462	187	256	319
Income Tax	-250	24	61	77
Profit from Continuing Operations	-1,212	163	195	242
Profit from Discontinued Operations	0	0	0	0
Net Profit	**-1,212**	**163**	**195**	**242**
Controlling Interests	-1,205	172	206	257
Non-Controlling Interests	-7	-10	-12	-15
Total Comprehensive Profit	**-1,256**	**163**	**195**	**242**
Controlling Interests	-1,249	162	194	241
Non-Controlling Interests	-7	1	1	1
EBITDA	-1,198	470	480	577
FCF (Free Cash Flow)	12	549	288	246
EBITDA Margin (%)	-12.3	4.4	5.1	5.9
Operating Profit Margin (%)	-15.5	1.7	2.2	3.2
Net Profit Margin (%)	-12.4	1.6	2.2	2.6

Statement of Financial Condition (Summarized)

(Wbn)	12/15	12/16F	12/17F	12/18F
Current Assets	**10,110**	**10,473**	**10,634**	**10,796**
Cash and Cash Equivalents	983	1,208	1,530	1,375
AR & Other Receivables	381	651	568	613
Inventories	1,449	1,020	935	986
Other Current Assets	7,297	7,594	7,601	7,822
Non-Current Assets	**7,191**	**7,167**	**7,005**	**6,977**
Investments in Associates	6	6	5	6
Property, Plant and Equipment	5,583	5,514	5,455	5,406
Intangible Assets	102	83	68	55
Total Assets	**17,302**	**17,640**	**17,639**	**17,773**
Current Liabilities	**9,570**	**9,715**	**9,762**	**10,137**
AP & Other Payables	1,520	1,658	1,674	1,696
Short-Term Financial Liabilities	3,190	3,068	3,061	0
Other Current Liabilities	4,860	4,989	5,027	8,441
Non-Current Liabilities	**3,466**	**3,497**	**3,254**	**2,770**
Long-Term Financial Liabilities	3,156	3,156	2,956	0
Other Non-Current Liabilities	310	341	298	2,770
Total Liabilities	**13,036**	**13,212**	**13,016**	**12,907**
Controlling Interests	**4,238**	**4,409**	**4,616**	**4,873**
Capital Stock	1,155	1,155	1,155	1,155
Capital Surplus	424	424	424	424
Retained Earnings	3,594	3,766	3,972	4,229
Non-Controlling Interests	**28**	**19**	**7**	**-8**
Stockholders' Equity	**4,266**	**4,428**	**4,623**	**4,865**

Cash Flows (Summarized)

(Wbn)	**12/15**	**12/16F**	**12/17F**	**12/18F**
Cash Flows from Op Activities	620	749	488	446
Net Profit	-1,212	163	195	242
Non-Cash Income and Expense	514	267	284	334
Depreciation	280	269	259	249
Amortization	24	19	15	12
Others	210	-21	10	73
Chg in Working Capital	1,808	349	69	-58
Chg in AR & Other Receivables	1,710	-265	78	-43
Chg in Inventories	-281	429	85	-51
Chg in AP & Other Payables	-320	127	31	16
Income Tax Paid	**-168**	**-24**	**-61**	**-77**
Cash Flows from Inv Activities	-1,081	-402	41	-341
Chg in PP&E	-570	-200	-200	-200
Chg in Intangible Assets	3	0	0	0
Chg in Financial Assets	-639	-252	191	-141
Others	**125**	**50**	**50**	**0**
Cash Flows from Fin Activities	1,104	-122	-207	-259
Chg in Financial Liabilities	1,427	-122	-207	-259
Chg in Equity	0	0	0	0
Dividends Paid	-51	0	0	0
Others	**-272**	**0**	**0**	**0**
Increase (Decrease) in Cash	643	225	321	-155
Beginning Balance	341	983	1,208	1,530
Ending Balance	**983**	**1,208**	**1,530**	**1,375**

Forecasts/Valuations (Summarized)

	12/15	**12/16F**	**12/17F**	**12/18F**
P/E (x)	-	12.2	10.2	8.2
P/CF (x)	-	4.9	4.4	3.7
P/B (x)	0.5	0.4	0.4	0.4
EV/EBITDA (x)	-	10.8	9.6	7.6
EPS (W)	-5,218	746	893	1,113
CFPS (W)	-3,023	1,860	2,074	2,495
BPS (W)	22,545	23,291	24,184	25,297
DPS (W)	0	0	0	0
Payout ratio (%)	0.0	0.0	0.0	0.0
Dividend Yield (%)	0.0	0.0	0.0	0.0
Revenue Growth (%)	-24.6	10.2	-12.7	5.5
EBITDA Growth (%)	-	-	2.1	20.2
Operating Profit Growth (%)	-	-	13.2	53.4
EPS Growth (%)	-	-	19.7	24.6
Accounts Receivable Turnover (x)	17.4	22.2	16.2	17.7
Inventory Turnover (x)	7.4	8.7	9.6	10.3
Accounts Payable Turnover (x)	7.3	6.7	5.5	5.7
ROA (%)	-7.0	0.9	1.1	1.4
ROE (%)	-24.7	4.0	4.6	5.4
ROIC (%)	-16.2	2.3	2.4	3.8
Liability to Equity Ratio (%)	305.6	298.3	281.5	265.3
Current Ratio (%)	105.6	107.8	108.9	106.5
Net Debt to Equity Ratio (%)	81.4	66.3	54.3	47.2
Interest Coverage Ratio (x)	-34.8	3.8	4.4	7.0

Source: Company data, Daewoo Securities Research estimates

Daewoo Shipbuilding & Marine Engineering (042660 KS)

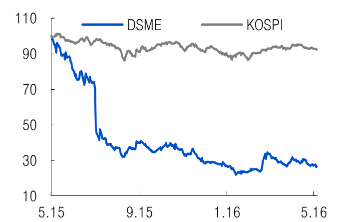
Bumpy road ahead

Shipbuilding

(Maintain)	Hold
Target Price (12M, W)	-
Share Price (05/18/16, W)	4,730
Expected Return	-

OP (16F, Wbn)	133
Consensus OP (16F, Wbn)	140
EPS Growth (16F, %)	-
Market EPS Growth (16F, %)	16.9
P/E (16F, x)	-
Market P/E (16F, x)	10.6
KOSPI	1,956.73
Market Cap (Wbn)	1,293
Shares Outstanding (mn)	273
Free Float (%)	39.3
Foreign Ownership (%)	9.1
Beta (12M)	1.35
52-Week Low	3,960
52-Week High	17,250

(%)	1M	6M	12M
Absolute	-12.4	-19.0	-72.3
Relative	-10.1	-18.8	-70.1



One challenge after another

Daewoo Shipbuilding & Marine Engineering (DSME) reported a modest operating loss in 1Q, but is projected to swing to positive territory on a full-year basis, as quarterly results should stabilize going forward. The firm has shaken off massive losses, and productivity is improving as loss-making large-scale projects are nearing completion and new constructions have decreased. Furthermore, increasing production of specialty ships (military vessels) and LNG-powered icebreakers (to be used in the Yamal project) should boost the firm's operating performance.

Despite the brightening outlook on the operating side, weak orders will likely weigh on the firm. Offshore plant orders, in particular, have been low for the past two years, with no sign of a pickup amid sustained low oil prices. Production facility orders may rise, but intensified competition should make it difficult to win orders.

DSME showed no progress in the commercial ship business in the past year. Order backlog has contracted to roughly 1.5 years. Amid the persistent global slump and intensifying competition, contraction of the newbuilding market appears inevitable. Shippers are cutting down or delaying order plans. Furthermore, the shipbuilder weak financials could hamper order-taking. In our view, the shipbuilder will have to depend on government support as its only resort.

Offshore plant risks could re-emerge amid low oil prices

If oil prices stay low for a long time, risks related to offshore plants are likely to emerge once again. In particular, uncertainties could arise regarding delivery of some drillships that DSME is currently building. Cancellation of delivery would lead to a snowballing financial burden (e.g., production costs, inventory losses). For now, given sluggish advances from new orders, the company needs to secure capital for operations.

Reiterate Hold

We retain our Hold call in light of significant uncertainties over liquidity. Given the company's high debt-to-equity ratio, continuing to operate should be tough without support from creditors, on whom the shipbuilder appears to be entirely reliant. Even though earnings are projected to swing to positive territory in the short term, this would not signal a recovery, as the declining order backlog should lead to top-line contraction.

We advise investors to take a wait-and-watch approach. Even if the stock rises on additional loans from creditors, the rise should be only temporary. Earnings improvement is likely to be challenging, considering the decline in order backlog (amid dismal shipbuilding market conditions) and intensifying competition. In addition, the possibility of a labor union conflict should be kept in mind. We are not ruling out the possibility of the shipbuilder going into court receivership if the market stays in a slump.

FY (Dec.)	12/13	12/14	12/15	12/16F	12/17F	12/18F
Revenue (Wbn)	15,305	15,455	15,007	12,636	11,928	12,048
OP (Wbn)	441	-743	-2,937	133	125	127
OP margin (%)	2.9	-4.8	-19.6	1.1	1.0	1.1
NP (Wbn)	269	-784	-3,195	-196	-189	-14
EPS (W)	1,406	-4,096	-16,519	-719	-690	-52
ROE (%)	5.6	-19.4	-163.9	-17.0	-12.8	-1.0
P/E (x)	24.9	-	-	-	-	-
P/B (x)	1.4	1.1	1.9	0.8	0.9	0.9

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

Daewoo Shipbuilding & Marine Engineering (042660 KS/Hold)

Comprehensive Income Statement (Summarized)

(Wbn)	12/15	12/16F	12/17F	12/18F
Revenue	**15,007**	**12,636**	**11,928**	**12,048**
Cost of Sales	**17,195**	**11,871**	**11,207**	**11,319**
Gross Profit	**-2,188**	**765**	**721**	**729**
SG&A Expenses	**750**	**632**	**596**	**602**
Operating Profit (Adj)	**-2,937**	**133**	**125**	**127**
Operating Profit	**-2,937**	**133**	**125**	**127**
Non-Operating Profit	**-1,110**	**-320**	**-314**	**-142**
Net Financial Income	-75	-146	-145	-143
Net Gain from Inv in Associates	-67	0	0	0
Pretax Profit	-4,047	-187	-189	-15
Income Tax	-776	0	0	-1
Profit from Continuing Operations	-3,271	-187	-189	-14
Profit from Discontinued Operations	-36	0	0	0
Net Profit	**-3,307**	**-187**	**-189**	**-14**
Controlling Interests	-3,195	-196	-189	-14
Non-Controlling Interests	-112	9	0	0
Total Comprehensive Profit	**-2,902**	**-187**	**-189**	**-14**
Controlling Interests	-2,808	-181	-182	-14
Non-Controlling Interests	-95	-6	-6	0
EBITDA	-2,696	357	334	321
FCF (Free Cash Flow)	-1,025	-752	142	146
EBITDA Margin (%)	-18.0	2.8	2.8	2.7
Operating Profit Margin (%)	-19.6	1.1	1.0	1.1
Net Profit Margin (%)	-21.3	-1.6	-1.6	-0.1

Statement of Financial Condition (Summarized)

(Wbn)	12/15	12/16F	12/17F	12/18F
Current Assets	**10,925**	**9,711**	**9,091**	**9,321**
Cash and Cash Equivalents	1,236	422	85	224
AR & Other Receivables	537	842	795	803
Inventories	2,014	1,685	1,590	1,606
Other Current Assets	7,138	6,762	6,621	6,688
Non-Current Assets	**8,131**	**7,954**	**7,752**	**7,584**
Investments in Associates	33	28	27	27
Property, Plant and Equipment	5,838	5,661	5,489	5,320
Intangible Assets	82	75	68	62
Total Assets	**19,056**	**17,665**	**16,843**	**16,905**
Current Liabilities	**15,707**	**13,526**	**12,901**	**12,973**
AP & Other Payables	2,184	1,694	1,580	1,596
Short-Term Financial Liabilities	7,536	6,444	5,933	0
Other Current Liabilities	5,987	5,388	5,388	11,377
Non-Current Liabilities	**2,912**	**2,870**	**2,861**	**2,866**
Long-Term Financial Liabilities	2,381	2,381	2,381	0
Other Non-Current Liabilities	531	489	480	2,866
Total Liabilities	**18,619**	**16,396**	**15,762**	**15,839**
Controlling Interests	**746**	**1,570**	**1,382**	**1,368**
Capital Stock	1,372	2,222	2,222	2,222
Capital Surplus	0	170	170	170
Retained Earnings	-1,042	-1,238	-1,427	-1,441
Non-Controlling Interests	**-310**	**-301**	**-301**	**-301**
Stockholders' Equity	**436**	**1,269**	**1,081**	**1,067**

Cash Flows (Summarized)

(Wbn)	**12/15**	**12/16F**	**12/17F**	**12/18F**
Cash Flows from Op Activities	-843	-712	172	166
Net Profit	-3,307	-187	-189	-14
Non-Cash Income and Expense	1,206	379	353	336
Depreciation	233	217	202	189
Amortization	8	7	6	6
Others	965	155	145	141
Chg in Working Capital	1,621	-759	151	-14
Chg in AR & Other Receivables	-91	-421	24	-4
Chg in Inventories	235	329	94	-16
Chg in AP & Other Payables	943	-433	-54	9
Income Tax Paid	**-134**	**0**	**0**	**1**
Cash Flows from Inv Activities	172	-35	0	-28
Chg in PP&E	123	-40	-30	-20
Chg in Intangible Assets	-12	0	0	0
Chg in Financial Assets	-39	15	30	-8
Others	**100**	**-10**	**0**	**0**
Cash Flows from Fin Activities	1,773	-72	-511	2
Chg in Financial Liabilities	1,951	-1,092	-511	2
Chg in Equity	410	1,020	0	0
Dividends Paid	-29	0	0	0
Others	**-559**	**0**	**0**	**0**
Increase (Decrease) in Cash	1,097	-814	-337	140
Beginning Balance	139	1,236	422	85
Ending Balance	**1,236**	**422**	**85**	**224**

Forecasts/Valuations (Summarized)

	12/15	**12/16F**	**12/17F**	**12/18F**
P/E (x)	-	-	-	-
P/CF (x)	-	6.7	7.9	4.0
P/B (x)	1.9	0.8	0.9	0.9
EV/EBITDA (x)	-	25.9	27.2	27.8
EPS (W)	-16,519	-719	-690	-52
CFPS (W)	-10,864	702	601	1,175
BPS (W)	2,731	5,743	5,053	5,001
DPS (W)	0	0	0	0
Payout ratio (%)	0.0	0.0	0.0	0.0
Dividend Yield (%)	0.0	0.0	0.0	0.0
Revenue Growth (%)	-2.9	-15.8	-5.6	1.0
EBITDA Growth (%)	-	-	-6.4	-3.9
Operating Profit Growth (%)	-	-	-6.0	1.6
EPS Growth (%)	-	-	-	-
Accounts Receivable Turnover (x)	0.0	60.0	29.1	30.1
Inventory Turnover (x)	7.4	6.8	7.3	7.5
Accounts Payable Turnover (x)	15.4	10.0	11.9	12.3
ROA (%)	-17.6	-1.0	-1.1	-0.1
ROE (%)	-163.9	-17.0	-12.8	-1.0
ROIC (%)	-26.4	1.6	1.5	1.5
Liability to Equity Ratio (%)	4,265.8	1,291.6	1,458.4	1,485.1
Current Ratio (%)	69.6	71.8	70.5	71.9
Net Debt to Equity Ratio (%)	1,948.8	650.4	748.6	745.5
Interest Coverage Ratio (x)	-30.8	0.8	0.8	0.8

Source: Company data, Daewoo Securities Research estimates

Hanjin Heavy Industries & Construction

(097230 KS)

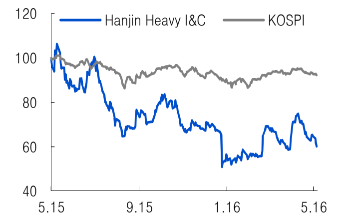
Property disposal is key

Shipbuilding

(Maintain)	Hold
Target Price (12M, W)	-
Share Price (05/18/16, W)	3,465
Expected Return	-

OP (16F, Wbn)	57
Consensus OP (16F, Wbn)	91
EPS Growth (16F, %)	-
Market EPS Growth (16F, %)	16.9
P/E (16F, x)	-
Market P/E (16F, x)	10.6
KOSPI	1,956.73
Market Cap (Wbn)	354
Shares Outstanding (mn)	102
Free Float (%)	61.3
Foreign Ownership (%)	5.6
Beta (12M)	2.31
52-Week Low	2,935
52-Week High	6,140

(%)	1M	6M	12M
Absolute	-15.4	-9.5	-36.1
Relative	-13.1	-9.2	-30.9



Stable order growth

Hanjin Heavy Industries & Construction (HHIC) has maintained stable order growth in the niche between small- and large-sized shipbuilders. The company has avoided direct competition with small- and large-sized players and has diversified production mix. Mid- to large-sized vessels account for the biggest proportion of the company's orders.

Of note, the company has gained competitive advantages over Chinese players based on its wide customer network, high recognition in the market, and productivity improvement at the Subic shipyard.

Laid the foundation to turn around

HHIC recently resumed its operations, having addressed a short-term liquidity crunch by signing an autonomous arrangement with creditors. However, the company is still weighed down by heavy financial costs due to slower-than-expected progress in property disposal. Although the company has real estate property worth W2tr, it pays W160bn in interest annually on borrowings of W3tr. As such, we think it is urgent for the company to pay back its debt by via property sales as soon as possible.

Although the Yeongdo shipyard has not yet normalized, the defense unit is propping up overall earnings. The Subic shipyard is expected to swing to an operating profit in 2016 thanks to 1) lower labor cost increase and 2) productivity growth. Of note, quality improvement at the Subic shipyard is anticipated to boost the company's orders going forward.

Construction orders and operating earnings are also stable. Housing earnings have improved thanks to the recovery of the domestic real estate market. In addition, the civil engineering unit is also anticipated to maintain stable orders and earnings based on high recognition in the market. The company is also projected to receive orders for facilities for the Pyeongchang Olympics next year. The energy unit should continue to deliver steady earnings on the normalization of capacity utilization.

Maintain Hold

We maintain our Hold call on HHIC. The company's operating performance is improving rapidly on the back of the strong growth of the Subic shipyard. On the non-operating side, however, financial structure remains unhealthy. The company's EV is unlikely to recover until it significantly reduces debt through asset disposal.

Currently, HHIC is trading at a P/B of 0.3x, the lowest level among domestic shipbuilders. The company's heavy financial cost burden is the biggest drag on its share price. If property disposal progresses smoothly, the stocks' upside potential should increase.

FY (Dec.)	12/13	12/14	12/15F	12/16F	12/17F	12/18F
Revenue (Wbn)	2,529	2,520	3,171	3,329	3,496	3,670
OP (Wbn)	-70	-145	10	57	73	84
OP margin (%)	-2.8	-5.8	0.3	1.7	2.1	2.3
NP (Wbn)	-189	-299	-145	-33	-17	-6
EPS (W)	-2,618	-3,491	-1,415	-325	-164	-56
ROE (%)	-11.3	-18.6	-9.6	-2.4	-1.2	-0.4
P/E (x)	-	-	-	-	-	-
P/B (x)	0.5	0.3	0.3	0.3	0.3	0.3

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

Hanjin Heavy Industries & Construction (097230 KS/Hold)

Comprehensive Income Statement (Summarized)

(Wbn)	12/15F	12/16F	12/17F	12/18F
Revenue	**3,171**	**3,329**	**3,496**	**3,670**
Cost of Sales	**2,993**	**3,099**	**3,240**	**3,395**
Gross Profit	**178**	**230**	**256**	**275**
SG&A Expenses	**168**	**173**	**182**	**191**
Operating Profit (Adj)	**10**	**57**	**73**	**84**
Operating Profit	**10**	**57**	**73**	**84**
Non-Operating Profit	**-191**	**-99**	**-94**	**-91**
Net Financial Income	-158	-138	-134	-132
Net Gain from Inv in Associates	-21	0	0	0
Pretax Profit	-181	-42	-21	-7
Income Tax	-36	-8	-4	-1
Profit from Continuing Operations	-145	-33	-17	-6
Profit from Discontinued Operations	0	0	0	0
Net Profit	**-145**	**-33**	**-17**	**-6**
Controlling Interests	-145	-33	-17	-6
Non-Controlling Interests	0	0	0	0
Total Comprehensive Profit	**-145**	**-53**	**-17**	**-6**
Controlling Interests	-145	-53	-17	-6
Non-Controlling Interests	0	0	0	0
EBITDA	104	148	161	170
FCF (Free Cash Flow)	-161	-44	-70	-76
EBITDA Margin (%)	3.3	4.4	4.6	4.6
Operating Profit Margin (%)	0.3	1.7	2.1	2.3
Net Profit Margin (%)	-4.6	-1.0	-0.5	-0.2

Statement of Financial Condition (Summarized)

(Wbn)	12/15F	12/16F	12/17F	12/18F
Current Assets	**2,718**	**2,754**	**2,827**	**2,949**
Cash and Cash Equivalents	287	242	190	180
AR & Other Receivables	587	617	647	680
Inventories	695	730	766	805
Other Current Assets	1,149	1,165	1,224	1,284
Non-Current Assets	**3,430**	**3,293**	**3,164**	**3,058**
Investments in Associates	123	126	132	138
Property, Plant and Equipment	2,539	2,378	2,220	2,085
Intangible Assets	69	69	69	69
Total Assets	**6,149**	**6,047**	**5,991**	**6,008**
Current Liabilities	**3,132**	**3,124**	**3,121**	**3,176**
AP & Other Payables	411	420	429	442
Short-Term Financial Liabilities	2,006	1,953	1,904	0
Other Current Liabilities	715	751	788	2,734
Non-Current Liabilities	**1,589**	**1,548**	**1,511**	**1,479**
Long-Term Financial Liabilities	1,252	1,202	1,152	0
Other Non-Current Liabilities	337	346	359	1,479
Total Liabilities	**4,721**	**4,672**	**4,633**	**4,655**
Controlling Interests	**1,429**	**1,376**	**1,359**	**1,354**
Capital Stock	511	511	511	511
Capital Surplus	712	712	712	712
Retained Earnings	99	65	49	43
Non-Controlling Interests	**-1**	**-1**	**-1**	**-1**
Stockholders' Equity	**1,428**	**1,375**	**1,358**	**1,353**

Cash Flows (Summarized)

(Wbn)	**12/15F**	**12/16F**	**12/17F**	**12/18F**
Cash Flows from Op Activities	-131	-14	-40	-26
Net Profit	-145	-33	-17	-6
Non-Cash Income and Expense	237	171	168	166
Depreciation	94	91	88	86
Amortization	0	0	0	0
Others	143	80	80	80
Chg in Working Capital	-101	-21	-61	-56
Chg in AR & Other Receivables	-22	-15	-16	-16
Chg in Inventories	-39	-35	-36	-38
Chg in AP & Other Payables	5	6	6	8
Income Tax Paid	**36**	**8**	**4**	**1**
Cash Flows from Inv Activities	384	92	73	21
Chg in PP&E	170	120	100	50
Chg in Intangible Assets	0	0	0	0
Chg in Financial Assets	-31	-28	-27	-29
Others	**245**	**0**	**0**	**0**
Cash Flows from Fin Activities	-203	-102	-99	-49
Chg in Financial Liabilities	-203	-102	-99	-49
Chg in Equity	0	0	0	0
Dividends Paid	0	0	0	0
Others	**0**	**0**	**0**	**0**
Increase (Decrease) in Cash	-63	-46	-52	-10
Beginning Balance	350	287	242	190
Ending Balance	**287**	**242**	**190**	**180**

Source: Company data, Daewoo Securities Research estimates

Forecasts/Valuations (Summarized)

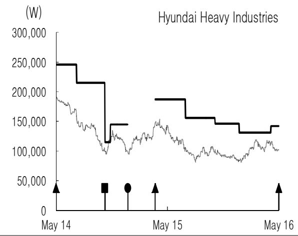
	12/15F	**12/16F**	**12/17F**	**12/18F**
P/E (x)	-	-	-	-
P/CF (x)	4.4	2.6	2.3	2.2
P/B (x)	0.3	0.3	0.3	0.3
EV/EBITDA (x)	31.6	21.5	19.4	18.1
EPS (W)	-1,415	-325	-164	-56
CFPS (W)	896	1,342	1,475	1,563
BPS (W)	13,984	13,467	13,303	13,247
DPS (W)	0	0	0	0
Payout ratio (%)	0.0	0.0	0.0	0.0
Dividend Yield (%)	0.0	0.0	0.0	0.0
Revenue Growth (%)	25.8	5.0	5.0	5.0
EBITDA Growth (%)	-	42.3	8.8	5.6
Operating Profit Growth (%)	-	470.0	28.1	15.1
EPS Growth (%)	-	-	-	-
Accounts Receivable Turnover (x)	11.0	10.9	10.9	10.9
Inventory Turnover (x)	4.7	4.7	4.7	4.7
Accounts Payable Turnover (x)	10.1	10.3	10.6	10.8
ROA (%)	-2.3	-0.5	-0.3	-0.1
ROE (%)	-9.6	-2.4	-1.2	-0.4
ROIC (%)	0.2	1.2	1.6	2.1
Liability to Equity Ratio (%)	330.5	339.7	341.1	344.2
Current Ratio (%)	86.8	88.2	90.6	92.9
Net Debt to Equity Ratio (%)	201.8	205.0	203.8	201.4
Interest Coverage Ratio (x)	0.1	0.4	0.5	0.6

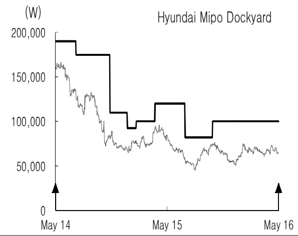
APPENDIX 1

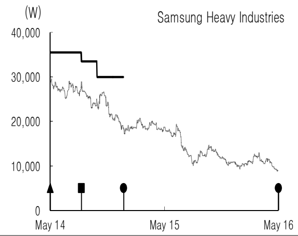
Important Disclosures & Disclaimers

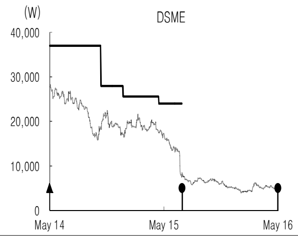
2-Year Rating and Target Price History

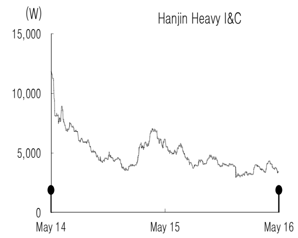
Company (Code)	Date	Rating	Target Price	Company (Code)	Date	Rating	Target Price
Hyundai Heavy Industries(009540)	04/27/2016	Buy	142,000		01/14/2015	Buy	92,500
	01/14/2016	Buy	131,000		11/18/2014	Buy	110,000
	10/27/2015	Buy	146,000		07/30/2014	Buy	175,000
	07/22/2015	Buy	156,000		05/15/2014	Buy	190,000
	04/14/2015	Buy	187,000	Samsung Heavy Industries(010140)	01/14/2015	Hold	-
	01/14/2015	Hold	-		10/21/2014	Trading Buy	30,000
	11/18/2014	Trading Buy	145,000		09/01/2014	Trading Buy	33,500
	10/31/2014	Trading Buy	115,000		05/15/2014	Buy	35,500
	07/30/2014	Buy	215,000	DSME(042660)	07/22/2015	Hold	-
	05/15/2014	Buy	246,000		05/08/2015	Buy	24,000
Hyundai Mipo Dockyard(010620)	10/20/2015	Buy	100,000		01/14/2015	Buy	25,600
	07/22/2015	Buy	82,000		11/04/2014	Buy	28,000
	04/15/2015	Buy	120,000		05/15/2014	Buy	37,000
	02/12/2015	Buy	100,000	Hanjin Heavy I&C(097230)	01/06/2014	Hold	-











Stock Ratings		Industry Ratings	
Buy	: Relative performance of 20% or greater	Overweight	: Fundamentals are favorable or improving
Trading Buy	: Relative performance of 10% or greater, but with volatility	Neutral	: Fundamentals are steady without any material changes
Hold	: Relative performance of -10% and 10%	Underweight	: Fundamentals are unfavorable or worsening
Sell	: Relative performance of -10%		

Ratings and Target Price History (Share price (—), Target price (▬), Not covered (■), Buy (▲), Trading Buy (■), Hold (●), Sell (◆))
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* 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
68.29%	17.56%	14.15%	0.00%

* Based on recommendations in the last 12-months (as of March 31, 2016)

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Daewoo Securities (Europe) Ltd. 41st Floor, Tower 42 25 Old Broad St. London EC2N 1HQ United Kingdom Tel: 44-20-7982-8000	**Daewoo Securities (Singapore) Pte. Ltd.** Six Battery Road #11-01 Singapore, 049909 Tel: 65-6671-9845	**Tokyo Branch** 7th Floor, Yusen Building 2-3-2 Marunouchi, Chiyoda-ku Tokyo 100-0005 Japan Tel: 81-3- 3211-5511
Beijing Representative Office 2401A, 24th Floor, East Tower, Twin Towers B-12 Jianguomenwai Avenue Chaoyang District, Beijing 100022 China Tel: 86-10-6567-9299	**Shanghai Representative Office** Room 38T31, 38F SWFC 100 Century Avenue Pudong New Area, Shanghai 200120 China Tel: 86-21-5013-6392	**Ho Chi Minh Representative Office** Suite 2103, Saigon Trade Center 37 Ton Duc Thang St, Dist. 1, Ho Chi Minh City, Vietnam Tel: 84-8-3910-6000
Daewoo Investment Advisory (Beijing) Co., Ltd. 2401B, 24th Floor, East Tower, Twin Towers B-12 Jianguomenwai Avenue, Chaoyang District, Beijing 100022 China Tel: 86-10-6567-9699	**Daewoo Securities (Mongolia) LLC** #406, Blue Sky Tower, Peace Avenue 17 1 Khoroo, Sukhbaatar District Ulaanbaatar 14240 Mongolia Tel: 976-7011-0807	**PT. Daewoo Securities Indonesia** Equity Tower Building Lt.50 Sudirman Central Business District Jl. Jendral Sudirman Kav. 52-53, Jakarta Selatan Indonesia 12190 Tel: 62-21-515-1140