

POSCO Daewoo

(047050 KS/Buy)

Blueprint for long-term growth

- Medium/long-term OP targets set at W700bn and W1tr, respectively.
- Firm plans to expand the LNG business by establishing an integrated value chain in line with POSCO Group's gas-to-power strategy
- The Myanmar gas field will maximize profits by further increasing output

IR meeting: Medium/long-term OP targets: W700bn and W1tr, respectively

POSCO Daewoo's CEO, Kim Young-sang, announced a strategy to overcome the limitations of the company's export/intermediary trade-centric growth model during an IR meeting held on January 26th. The highlights of the new growth portfolio include: 1) a selective focus on strategic businesses; 2) investment-oriented business models, and 3) balanced growth between domestic and overseas businesses. The firm's medium-term (2020-2022) operating profit target is W700bn (including W500bn from steel/E&P and more than W150bn from new businesses), and the long-term target (2030) is W1tr. The company unveiled plans for two core businesses and three new businesses:

1) Steel: Operating profit from the steel unit should nearly double to W200bn (from W110bn, adjusted for one-off factors) through the expansion of distribution channels, a steel raw materials business linked to group companies, and advances into local distribution markets. POSCO Daewoo is set to start a new venture in the US by establishing an oil country tubular goods (OCTG) distributor (2Q18) and seeking investments/partnerships from local re-rollers.

2) E&P: POSCO Daewoo plans to expand its E&P activities to Indonesia, Papua New Guinea, and Australia. As part of the group's gas-to-power strategy to secure LNG assets, the firm is set to establish an integrated energy value chain, encompassing gas mining, trading, import terminals, piping, power generation, and bunkering. POSCO Daewoo plans to acquire import terminals in Asia and North America and use the Gwangyang Terminal in Korea.

3) Grain/oilseed: The firm plans to acquire a grain export terminal in Ukraine (scheduled to open in 2019), and will develop a palm oil plantation in Indonesia as a new cash cow business. If the farm turns a profit by 2020, the firm will acquire a new palm oil plantation area and processing plant in Indonesia.

4) Auto parts: POSCO Daewoo is set to diversify its CKD business to include Myanmar and Algeria, as well as to forge partnerships with Hyundai-Kia Automotive Group's production and distribution subsidiaries in Laos, Iran, and Uzbekistan. POSCO Daewoo will expand partnerships with auto parts suppliers for electric vehicles (EVs), while marketing its EV platforms in China, Eastern Europe, and the ASEAN region.

5) Power generation: The firm has been successfully running the Port Moresby and LAE power plants in Papua New Guinea and is close to entering a PPA deal with Myanmar conglomerate Shwe Taung Group. POSCO Daewoo will further accumulate power generation assets in Myanmar, Indonesia, and Bangladesh, and launch PV power generation businesses in Honduras (55MW) and Uzbekistan (2GW).

FY (12)	12/14	12/15	12/16	12/17F	12/18F	12/19F
Revenue (Wbn)	20,408	17,527	16,492	22,572	23,677	23,755
OP (Wbn)	376	369	318	401	463	492
OP margin (%)	1.8	2.1	1.9	1.8	2.0	2.1
NP (Wbn)	185	129	111	168	293	316
EPS (W)	1,620	1,132	977	1,376	2,377	2,564
ROE (%)	8.0	5.3	4.5	6.2	9.8	9.7
P/E (x)	19.4	14.4	27.6	13.2	10.1	9.4
P/B (x)	1.5	0.8	1.2	0.8	1.0	0.9
Dividend yield (%)	1.6	3.1	1.9	2.8	2.5	2.9

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

Q&A

1) What is the LNG trading unit's role in POSCO Group?

- POSCO Daewoo is the second largest company under POSCO Group, following POSCO. Over the past seven to eight years since POSCO acquired Daewoo International, differences in corporate cultures and respective competences have been well understood and recognized.
- POSCO Daewoo was the first Korean trading company to enter the LNG trading market. In 2017, POSCO Daewoo supplied to Korea Midland Power and entered three cargo trading deals (60,000 tonnes each) with Essar Steel.
- Demand from POSCO Group alone amounts to 2.7m-3m tonnes, and when considering bunkering needs, demand will further increase by 0.5m-1m tonnes. Thanks to captive demand, POSCO Daewoo is likely to source and distribute more than 5m tonnes.
- Currently, subsidiaries are discussing to align their respective positions with the group-wide LNG business. An equivalent of SK E&S can be created under POSCO Group.
- POSCO will take the lead in investing large-scale investments, such as shale gas and liquefied gas plants. In general, it is the nature of an E&P project that determines whether POSCO or POSCO Daewoo takes ownership in the project. Currently, we are screening Indonesia, Papua New Guinea, and Australia to make investments at any time when it makes sense to do so.

2) Are there any plans to further invest in Block AD-7/DS-12?

- Based on exploration and appraisal results of Block AD-7, the firm is contemplating over whether to make additional investments in Tallinn blocks. The firm is reviewing both deep sea and shallow sea structures. If additional drilling comes to pass, it will be around 2019.
- Despite its proximity, DS-12 is different from AD-7, in that its primary target is shallow layers. Through 2D exploration, 12 potential structures have been detected. The firm will determine whether to proceed with the project based on the outcome of 3D artificial seismic wave exploration.
- Bangladesh is an important player in the gas-fired power generation market, as the share of gas in the national fuel mix reaches an estimated 50%. As Bangladesh requires infrastructure investments encompassing pipeline, terminal and storage, POSCO Daewoo is working with various partners, such as KOGAS and ExxonMobil, to meet the demand.

3) Risks of additional impairment losses

- POSCO Daewoo has set its 2018 operating profit target at W470bn, conservatively reflecting potential losses related to overseas operation, restructuring expenses, and additional credit costs (W16.6bn).
- BSPC: Of impaired assets worth W64bn-65bn, the company has already written off W17bn, with liabilities accounting for the remaining amount. Given the liens on BSPC's real estate and property price increases, we believe the risks of additional impairment losses are limited.
- Ambatovy mine: The firm has invested US\$350m in the Ambatovy mine. Due to nickel price falls, POSCO Daewoo declared an exit from the consortium, applying for mediation in 2016. As POSCO Daewoo has recognized related losses, the outcome of mediation is unlikely to make a huge impact on the book. The firm has selected an appraiser in this regard, appraisal results will be available in March.

4) Dividend

- 2017 DPS is set at W500. Although the firm can afford to raise DPS up to W600, it has decided to prioritize financing new investment opportunities in 2018.
- If the firm fares well this year, it will distribute more to shareholders.

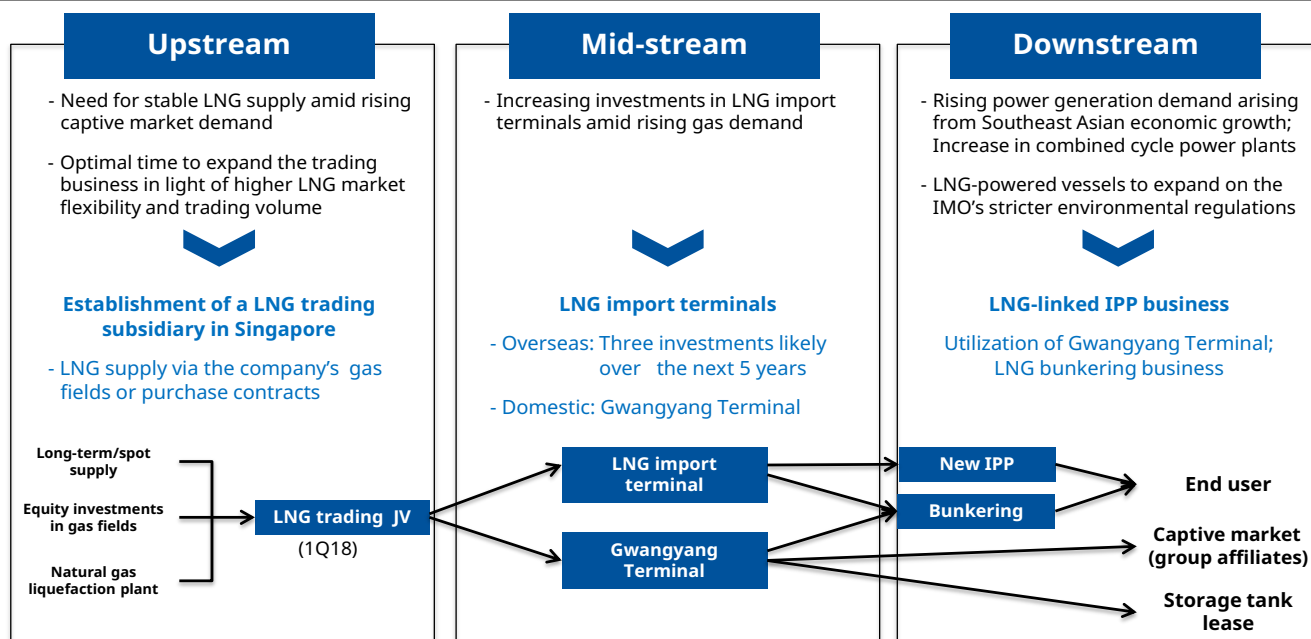
5) Myanmar gas field

- The firm has a production/sale contract for 500MMCFD with China and Myanmar (4:1) and is supplying a total of 630MMCFD, including 540MMCFD to China and 90MMCFD to Myanmar. The Myanmar gas field’s production is nearing its maximum capacity (640MMCFD).
- The firm does not know exactly why, but is seeing higher demand from China than those agreed under the take-or-pay (TOP) contract, probably due to a winter season and growing awareness about eco-friendly fuel. Demand is likely to further expand, once gas-fired power generation begins in Myanmar as well.
- As the deal with China and Myanmar is a depletion contract (in which the buyers agree to purchase all the gas extracted from a particular field over an uncertain period), the firm is allowed to sell more than the contracted volume (400MMCFD) to China. The firm is trying to produce as much as possible.

Long-term growth plan to remove uncertainties

We maintain our Buy rating and target price of W29,000 on POSCO Daewoo. We are encouraged by the recent IR meeting, as the firm unveiled a blueprint for long-term growth, expressed its commitment to expanding its LNG businesses to meet growing demand, and removed uncertainties over additional impairment losses. The firm is likely to increase its dividend; we estimate dividend yield at 2.5% (based on 2018F DPS of W600), which should provide downside support after share price rallies.

Figure 1. POSCO Group’s gas-to-power strategy



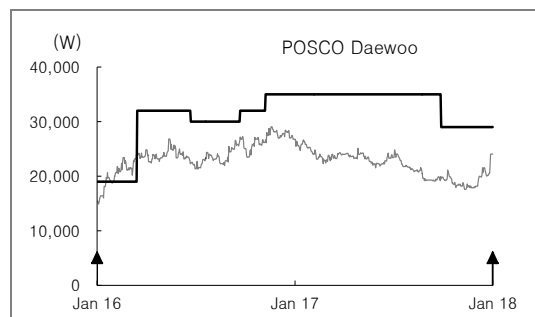
Source: Company data, Mirae Asset Daewoo Research

APPENDIX 1

Important Disclosures & Disclaimers

2-Year Rating and Target Price History

Company (Code)	Date	Rating	Target Price
POSCO Daewoo (047050)	10/26/2017	Buy	29,000
	12/06/2016	Buy	35,000
	10/20/2016	Buy	32,000
	07/21/2016	Buy	30,000
	04/13/2016	Buy	32,000
	01/14/2016	Buy	19,000



Stock Ratings

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

Industry Ratings

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

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

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

* Although it is not part of the official ratings at Mirae Asset Daewoo Co., Ltd., 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.

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	Buy	Trading Buy	Hold	Sell
Equity Ratings Distribution	75.50%	16.00%	8.50%	0.00%
Investment Banking Services	62.50%	33.33%	4.17%	0.00%

* Based on recommendations in the last 12-months (as of December 31, 2017)

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