

Hyundai Heavy Industries (009540 KS)

BUY (M) / TP: W600,000 (M)

Jae-won Lee

spirit@myasset.com
+822-3770-3550

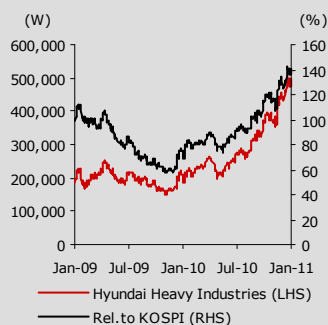
January 28, 2011

KOREA Shipbuilding

Share price (W, Jan 27)	501,000
Paid-in capital (Wbn)	3,800
Market cap (Wbn)	38,076
BPS (W)	144,525
Net debt to equity (%)	1.5
Shares outstanding	76,000,000
Avg daily T/O (2M, Wbn)	123
Avg daily vol. (2M, shrs)	293,790
52-week high (W)	504,000
52-week low (W)	187,000
Foreign ownership (%)	20.1
Major shareholders (%)	
	Mong-joon Chung and others 21.3

Stock performance (%)

	1M	3M	12M
Absolute	12.6	36.7	158.9
Relative	8.2	21.7	99.0
Abs (US\$)	15.4	37.4	161.8



Source: Datastream

4Q10 best ever; orders, profit to both rise in 2011

4Q10: highest quarterly earnings ever

Hyundai Heavy Ind (HHI) reported preliminary 4Q sales of W6.4tn (+20.6% y-y, +20.6% q-q), operating profit of W983.0bn (+44.6% y-y, +23.1% q-q), and pre-tax profit of W1.3tn (+59.5% y-y, +25.6% q-q), with operating margin of 15.3% (+0.3%p q-q). Operating profit beat our forecast by 6.1% and consensus by 7.5%. Sales, operating profit, and pre-tax profit all set quarterly records.

Strong top-line growth in 4Q was driven by the shipbuilding and engine divisions, which have seen increasing work since end-2010, vs a slowdown in 2H09 amid sluggish orders. In particular, shipbuilding sales growth picked up from -14.4% y-y in 3Q to 1% y-y in 4Q, while engine sales growth rose from -8.6% y-y to 43.8% y-y. Electronics and construction equipment sales also jumped 28.9% and 67.3% y-y, respectively.

Operating margin improved 2.6%p y-y and 0.3%p q-q. We believe that while most divisions' operating margins remained almost flat q-q, offshore and plant operating margins soared much higher than their 3Q figures of 24.1% and 10.2%, respectively, thanks to changes in already existing orders.

With some subsidiaries seeing one-off gains, equity-method gains increased 33% q-q to W364.5bn in 4Q, up from W274.1bn in 3Q, bolstering pre-tax profit growth.

Profits and orders to expand together; maintain BUY

Strong earnings growth should continue into 2011, and HHI is likely to set another earnings record in 4Q11. We expect shipbuilding order momentum to be solid, especially in containerships, and non-shipbuilding businesses (eg, offshore, plant, and engine) should also show strong order growth. We have a positive outlook on HHI, as we expect orders and profits to grow in tandem. We maintain BUY with a target price of W600,000.

Forecasts and valuations

FY to Dec	2008	2009	2010E	2011E	2012E
Sales (Wbn)	19,957.1	21,142.2	22,405.2	25,335.1	24,571.2
Chg (% y-y)	28.5	5.9	6.0	13.1	-3.0
OP (Wbn)	2,206.2	2,222.6	3,438.5	3,586.3	3,292.3
NP (Wbn)	2,256.7	2,146.5	3,763.5	3,978.5	3,763.3
EPS (W)	29,693.0	28,243.3	49,519.6	52,348.6	49,516.5
Chg (% y-y)	30.0	-4.9	75.3	5.7	-5.4
P/E (x)	9.9	6.9	10.1	9.6	10.1
P/B (x)	3.3	1.4	2.6	2.1	1.7
EV/EBITDA	7.6	5.6	7.7	7.2	7.1
ROE (%)	40.7	27.9	32.0	25.6	19.6
Div yield (%)	2.5	2.0	0.7	0.7	0.7

Source: Tong Yang Securities

4Q10 earnings beating our forecasts and consensus (Wbn)					
	Prelim 4Q10	Our forecast	Diff	Consensus	Diff
Sales	6,429.9	6,448.7	-0.3%	6,157.9	4.4%
Operating profit	983.0	926.6	6.1%	914.0	7.5%
Pre-tax profit	1,347.5	1,201.0	12.2%	1,077.7	25.0%
Net profit	1,061.0	966.4	9.8%	894.7	18.6%
Operating margin	15.3%	14.4%	0.9%pt	14.8%	0.4%pt
Pre-tax margin	21.0%	18.6%	2.3%pt	17.5%	3.5%pt
Net margin	16.5%	15.0%	1.5%pt	14.5%	2.0%pt

Source: Tong Yang Securities

Prelim 4Q10 results, by division: shipbuilding and engine sales growth turns positive Y-Y

	4Q09	3Q10	4Q10P	Chg (% y-y)	Chg (% q-q)
Sales (Wbn)	5,331.7	5,333.7	6,429.9	20.6%	20.6%
➔ Shipbuilding	2,189.8	1,817.7	2,211.8	1.0%	21.7%
Offshore	725.0	917.5	1,025.6	41.5%	11.8%
Plant	617.2	710.2	647.9	5.0%	-8.8%
➔ Engine	699.6	575.6	1,005.7	43.8%	74.7%
Electronics	739.4	714.4	953.1	28.9%	33.4%
Construction/machinery	325.3	560.3	544.3	67.3%	-2.9%
Other	35.4	38.0	41.5	17.2%	9.3%
Operating profit (Wbn)	679.7	798.8	983.0	44.6%	23.1%
Shipbuilding	291.8	245.6	-	-	-
Offshore	83.2	220.8	-	-	-
Plant	88.7	72.3	-	-	-
➔ Engine	196.7	147.2	-	-	-
Electronics	80.8	112.8	-	-	-
Construction/machinery	-6.5	64.4	-	-	-
Other	-55.0	-64.3	-	-	-
Pre-tax profit	845.0	1,073.0	1,347.5	59.5%	25.6%
Net profit	721.3	863.4	1,061.0	47.1%	22.9%
EBITDA	795.4	922.3	-	-	-
Operating margin (%)	12.7%	15.0%	15.3%	2.5%p	0.3%p
Shipbuilding	13.3%	13.5%	-	-	-
Offshore	11.5%	24.1%	-	-	-
Plant	14.4%	10.2%	-	-	-
➔ Engine	28.1%	25.6%	-	-	-
Electronics	10.9%	15.8%	-	-	-
Construction/machinery	-2.0%	11.5%	-	-	-
Other	-155.2%	-169.2%	-	-	-

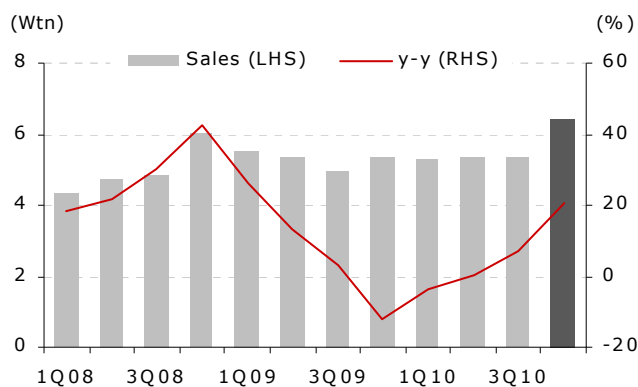
Source: Hyundai Heavy Industries, Tong Yang Securities

Sales and OP contribution by division: portion of shipbuilding and engine grew q-q

	4Q09	3Q10	4Q10P	Diff (y-y)	Diff (q-q)
Sales					
Shipbuilding	41.1%	34.1%	34.4%	-6.7%p	0.3%p
Offshore	13.6%	17.2%	16.0%	2.4%p	-1.3%p
Plant	11.6%	13.3%	10.1%	-1.5%p	-3.2%p
Engine	13.1%	10.8%	15.6%	2.5%p	4.8%p
Electronics	13.9%	13.4%	14.8%	1.0%p	1.4%p
Construction/machinery	6.1%	10.5%	8.5%	2.4%p	-2.0%p
Other	0.7%	0.7%	0.6%	0.0%p	-0.1%p
Operating profit					
Shipbuilding	42.9%	30.7%	-	-	-
Offshore	12.2%	27.6%	-	-	-
Plant	13.0%	9.0%	-	-	-
Engine	28.9%	18.4%	-	-	-
Electronics	11.9%	14.1%	-	-	-
Construction/machinery	-1.0%	8.1%	-	-	-

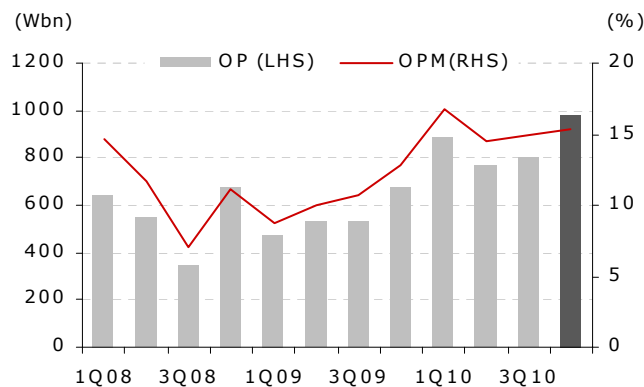
Source: Hyundai Heavy Industries, Tong Yang Securities

Quarterly sales



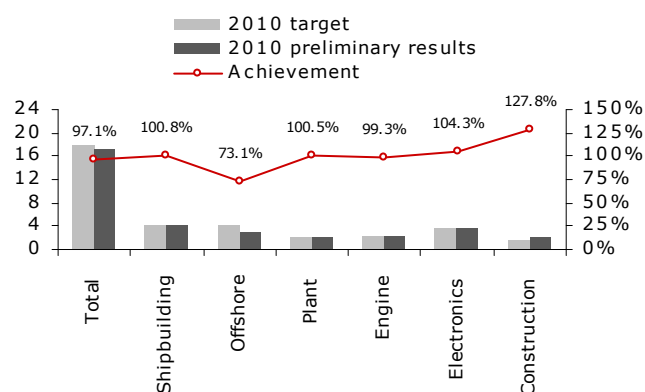
Source: Tong Yang Securities

Quarterly operating profit



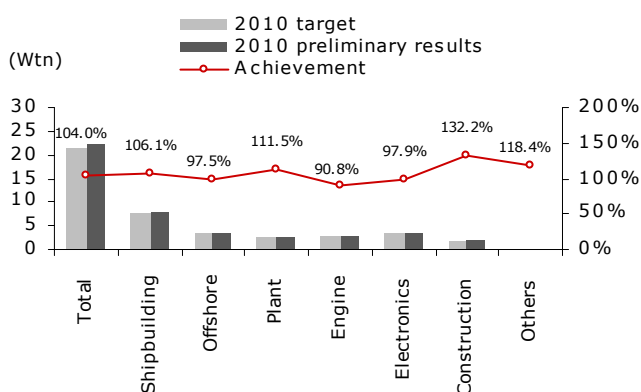
Source: Tong Yang Securities

On track to meet 2010 order target



Source: Tong Yang Securities

On track to meet 2010 sales target



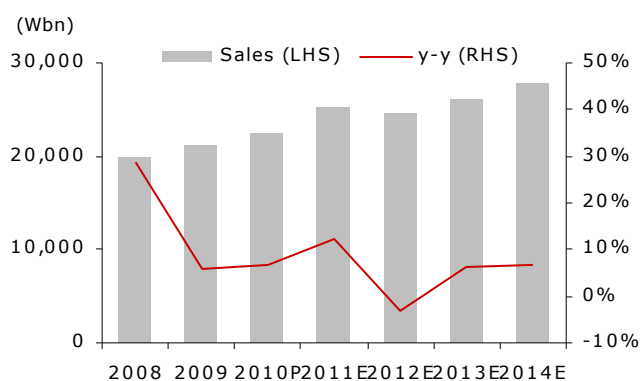
Source: Tong Yang Securities

2011 plan: broad-based order growth; shipbuilding, electronics sales to surge

	Orders (US\$mn)			Sales (Wbn)		
	Prelim 2010	2011 plan	y-y	Prelim 2010	2011 plan	y-y
Total	17,209	26,635	54.8%	22,405.2	26,945.0	20.3%
Shipbuilding	4,061	7,472	84.0%	7,849.2	9,470.0	20.6%
Offshore	3,069	4,800	56.4%	3,412.8	3,900.0	14.3%
Plant	2,010	3,800	89.1%	2,644.5	3,020.0	14.2%
Engine	2,283	3,220	41.0%	2,834.7	3,181.4	12.2%
Electronics	3,793	5,000	31.8%	3,242.2	4,616.8	42.4%
Construction/machinery	1,993	2,343	17.6%	2,274.6	2,600.0	14.3%
Other				147.2	156.8	6.5%

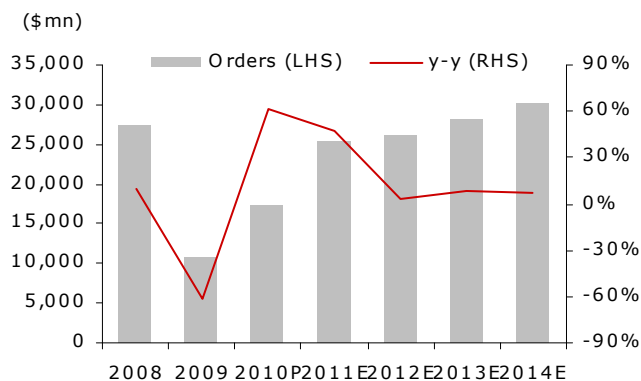
Source: Tong Yang Securities

Our order forecasts



Source: Tong Yang Securities

Our sales forecast



Source: Tong Yang Securities

Hyundai Heavy Industries (009540 KS) pro forma financial statements

Balance sheet

FY to Dec (Wbn)	2008	2009	2010E	2011E	2012E
Current assets	12,617.6	10,609.9	13,040.1	18,378.2	20,415.4
Cash & cash equivalents	667.5	632.6	925.7	2,237.5	4,332.4
Marketable securities	1,778.9	109.0	92.8	127.4	139.7
Accounts receivable	4,498.9	4,973.5	6,407.4	8,295.8	8,045.6
Inventory	2,263.3	1,928.6	2,375.9	3,076.2	2,983.4
Others	3,379.1	2,966.2	3,238.3	4,641.4	4,914.3
Non-current assets	12,662.8	14,262.7	17,933.7	19,216.3	20,218.6
Investments	3,224.4	4,866.4	8,821.7	9,954.5	10,970.1
Tangible assets	6,190.0	8,145.5	8,011.2	7,944.6	7,980.6
Intangible assets	262.3	288.5	297.6	277.2	259.2
Others	2,986.2	962.3	803.3	1,040.0	1,008.6
Total assets	25,280.4	24,872.6	30,973.8	37,594.5	40,634.0
Current liabilities	16,473.9	12,909.1	15,102.0	17,403.0	16,964.7
Accounts payable	2,337.3	1,427.6	1,886.9	2,297.9	2,228.7
Short term debt	0.0	585.3	2,865.6	2,865.6	2,865.6
Current long term debt	0.0	0.0	0.0	0.0	0.0
Others	14,136.6	10,896.2	10,349.6	12,239.5	11,870.5
Non-current liabilities	3,211.3	2,155.1	2,182.1	2,735.4	2,662.1
Debentures	0.0	299.1	299.4	299.4	299.4
Long term debt	3.3	5.2	5.2	5.2	5.2
Others	3,208.0	1,850.9	1,877.5	2,430.9	2,357.6
Total liabilities	19,685.2	15,064.2	17,284.1	20,138.4	19,626.8
Paid-in capital	380.0	380.0	380.0	380.0	380.0
Capital surplus	2,818.6	2,869.6	2,954.5	2,954.5	2,954.5
Capital adjustment	-1,762.0	-1,697.8	-1,634.3	-1,634.3	-1,634.3
Other accum. compre. income	-498.5	1,752.7	1,934.3	1,934.3	1,934.3
Retained earnings	4,657.1	6,504.0	10,055.3	13,821.6	17,372.7
Total shareholders' equity	5,595.2	9,808.4	13,689.7	17,456.0	21,007.1
Total debt	3.3	889.6	3,170.1	3,170.1	3,170.1
Net debt	-2,458.4	144.7	2,149.8	803.1	-1,304.3

Cash flow

FY to Dec (Wbn)	2008	2009	2010E	2011E	2012E
Operating cash flow	2,382.7	-958.0	1,122.3	1,684.2	2,942.5
Net profit	2,256.7	2,146.5	3,763.5	3,978.5	3,763.3
Non-cash revenue/expense	1,361.1	2,503.2	465.6	-190.2	-51.5
Depreciation	347.3	399.7	444.9	426.6	463.9
Amortization	43.5	46.0	52.0	47.7	44.5
Others	970.3	2,057.5	-31.3	-664.5	-559.9
Chg in operating assets/liab.	-1,235.0	-5,607.7	-3,106.7	-2,104.1	-769.3
Decr. (incr) in accounts receivable	-1,724.0	-539.7	-1,915.5	-2,301.8	-150.9
Decr. (incr) in inventory	-1,144.1	303.8	-447.4	-700.2	92.7
Incr. (decr) in accounts payable	854.6	-900.8	466.9	411.1	-69.3
Others	778.4	-4,471.0	-1,210.8	486.9	-641.9
Investing cash flows	-1,183.7	336.8	-3,253.2	-687.2	-535.9
Decr. (incr) in tangible assets	-1,708.0	-1,050.7	-376.1	-360.0	-500.0
Decr. (incr) in intangible assets	-69.7	-72.1	-61.1	-27.3	-26.5
Decr. (incr) in investments	-271.3	-249.5	-2,635.6	-0.4	-0.2
Others	865.3	1,709.1	-180.3	-299.6	-9.2
Financing cash flows	-1,485.3	586.3	2,423.9	314.9	-311.7
Incr. (decr) in debentures& debt	-186.0	886.0	2,282.4	0.0	0.0
Incr. (decr) in equity	-1,299.3	-299.7	-212.2	-212.2	-212.2
Dividend payout	-466.6	-299.7	-212.2	-212.2	-212.2
Others	0.0	0.0	353.7	527.1	-99.5
Increase in cash	-286.3	-34.9	293.1	1,311.9	2,094.9
Beginning cash	953.8	667.5	632.6	925.7	2,237.5
Ending cash	667.5	632.6	925.7	2,237.5	4,332.4

Source: Company data, Tong Yang Securities estimates

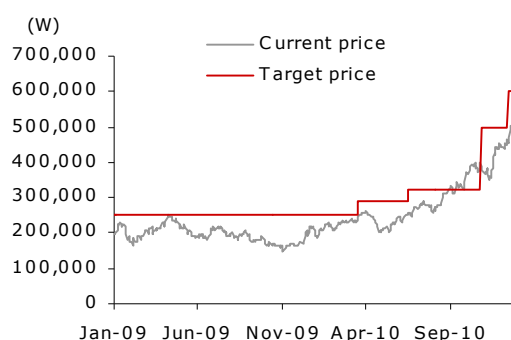
Income statement

FY to Dec (Wbn)	2008	2009	2010E	2011E	2012E
Sales	19,957.1	21,142.2	22,405.2	25,335.1	24,571.2
Cost of goods sold	16,812.0	17,997.4	17,734.9	20,272.3	19,809.0
Gross profit	3,145.1	3,144.8	4,670.4	5,062.8	4,762.3
SG&A expenses	938.9	922.2	1,231.8	1,476.6	1,469.9
Operating profit	2,206.2	2,222.6	3,438.5	3,586.3	3,292.3
Non-operating revenue	3,827.1	3,309.6	4,556.9	4,980.5	4,911.5
Financial income	279.9	167.3	192.5	372.3	513.1
FX gains	817.8	748.6	416.6	297.6	297.6
Equity method gains	771.5	479.6	1,158.9	1,170.5	1,053.4
Others	1,957.9	1,914.1	2,788.9	3,140.1	3,047.4
Non-operating expenses	3,083.6	2,884.1	3,208.1	3,530.7	3,440.2
Financing costs	6.5	34.1	90.1	140.7	140.7
FX losses	762.3	606.8	492.9	352.1	352.1
Equity method losses	151.6	194.6	42.3	38.0	38.0
Others	2,163.3	2,048.5	2,582.8	2,999.9	2,909.4
Recurring profit	2,949.6	2,648.1	4,787.3	5,036.1	4,763.6
Extraordinary gains/losses	0.0	0.0	0.0	0.0	0.0
Earnings before tax	2,949.6	2,648.1	4,787.3	5,036.1	4,763.6
Income tax	693.0	501.6	1,023.9	1,057.6	1,000.4
Earnings from cont. operations	2,256.7	2,146.5	3,763.5	3,978.5	3,763.3
Earnings from disc. operations	0.0	0.0	0.0	0.0	0.0
Income tax effect	0.0	0.0	0.0	0.0	0.0
Net profit	2,256.7	2,146.5	3,763.5	3,978.5	3,763.3
Gross margin (%)	15.8	14.9	20.8	20.0	19.4
EBITDA margin (%)	13.0	12.6	17.6	16.0	15.5
OP margin (%)	11.1	10.5	15.4	14.2	13.4
RP margin (%)	14.8	12.5	21.4	19.9	19.4
Earnings before tax margin	14.8	12.5	21.4	19.9	19.4
NP margin (%)	11.3	10.2	16.8	15.7	15.3
Adj. NP margin (%)	11.3	9.9	16.8	15.7	15.3

Key financial data

FY to Dec (Wbn)	2008	2009	2010E	2011E	2012E	
FCF	857.5	-3,360.6	773.5	1,546.0	2,172.6	
EBIT	2,206.2	2,222.6	3,438.5	3,586.3	3,292.3	
EBITDA	2,597.0	2,668.2	3,935.5	4,060.5	3,800.8	
SPS (W)	262,593.2	278,186.8	294,805.6	333,356.2	323,305.8	
EPS (W)	29,693.0	28,243.3	49,519.6	52,348.6	49,516.5	
DPS (W)	5,000.0	3,500.0	3,500.0	3,500.0	3,500.0	
BPS (W)	90,294.3	144,525.2	194,639.6	244,464.2	291,425.7	
EBITDAPS (W)	34,170.6	35,108.5	51,782.2	53,427.8	50,009.9	
Sales growth	28.5	5.9	6.0	13.1	-3.0	
OP growth	26.0	0.7	54.7	4.3	-8.2	
EPS growth	30.0	-4.9	75.3	5.7	-5.4	
EBITDA growth	21.2	2.7	47.5	3.2	-6.4	
ROA	10.7	8.6	13.5	11.6	9.6	
ROE	40.7	27.9	32.0	25.6	19.6	
ROIC		Impaired capital	Impaired capital	44.6	37.0	30.5
Dividend yield	2.5	2.0	0.7	0.7	0.7	
PSR (x)	1.1	0.7	1.7	1.5	1.6	
PER (x)	9.9	6.9	10.1	9.6	10.1	
PBR (x)	3.3	1.4	2.6	2.1	1.7	
EV/EBITDA (x)	7.6	5.6	7.7	7.2	7.1	
Liabilities ratio (%)	351.8	153.6	126.3	115.4	93.4	
Net debt/equity ratio (%)	-43.9	1.5	15.7	4.6	-6.2	
Net financing costs/sales	-4.6	-1.9	-5.3	-5.3	-5.6	
OP/financing costs (x)	340.9	65.1	38.2	25.5	23.4	

Hyundai Heavy Industries (009540 KS) ratings and target price history



Date	Rating	TP (W)
2010/04/14	BUY	290,000
2010/07/14	BUY	320,000
2010/11/22	BUY	500,000
2011/01/10	BUY	600,000

Source: Tong Yang Securities

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 - Buy: Low Risk if a stock is expected to return 10% or more; High Risk if a stock is expected to return 20% or more
 - Hold: Low Risk if a stock is expected to return between -10 and +10%; High Risk if a stock is expected to return between -20 and +20%
 - Sell: Low Risk if a stock is expected to decline by 10% or more; High Risk if a stock is expected to fall by 20% or more
- **Sector ratings** suggest 6 to 12 - month forward investment weighting of a given sector compared to its market capitalization weighting.
 - Overweight: Investment weighting is higher than the market capitalization weighting
 - Neutral: Investment weighting is equal to the market capitalization weighting
 - Underweight: Investment weighting is lower than the market capitalization weighting

Tong Yang Securities International Network

Seoul

Head Office

Tong Yang Securities Building

185 Euljiro 2-ga, Jung-gu
Seoul, Korea 100-845
Tel: +822-3770-3454
Corporate website: www.tys.co.kr/english

Research Center

Tong Yang Securities Building

#23-8 Yeoido-dong
Youngdeungpo-gu, Seoul, Korea
Tel: +822-3770-3436

Hong Kong

Tong Yang Securities Hong Kong Limited

Unit 3208-09, 32/F, Alexandra House
18 Chater Road, Central, Hong Kong
Tel: +85-2-3980-6000

New York

150 East 52nd Street
25th Floor New York
NY 10022, U.S.A.
Tel: +1-212-415-1008

Tokyo

803-3-4-1, Shin-Kokusai Building
Maronouchi, Chiyoda-ku
Tokyo, Japan 100-0005
Tel: +81-3-6269-9720

Ho Chi Minh

Suite 2905, Saigon Trade Center
37 Ton Dou Thang Street
District 1, Ho Chi Minh City, Vietnam
Tel: +84-8-910-6711

Manila

Tong Yang Savings Bank

Ground Floor, Chantham House
116 Valero Corner, Herrera Street
Salcedo Village, Makati City
Metro Manila, Philippines
Tel: +63-2-845-3838

Phnom Penh

#138, Norodom Boulevard
Sangkat Tonle Bassac
Khan Chamkarmorn
Phnom Penh, Cambodia
Tel: +855-23-224-125