

## Hyundai Heavy Industries (009540)

### BUY (Maintain)

TP: W450,000 (Up)

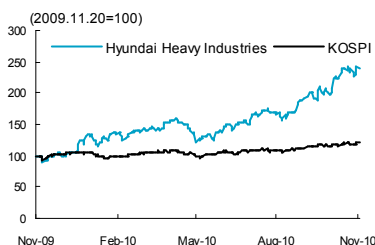
KOSPI (Nov 22)	1,944
Stock price (Nov 22)	391,000
Shares outstanding (mn)	76.0
Market cap (USD mn)	26,398
52-Week Low/High (won)	148,500/399,000
6M avg. daily turnover (USD mn)	84.3
Free float (%)	58.4
Dividend yield (2010F, %)	0.9
Foreign ownership (%)	19.3
Major shareholders (%)	

Mong-Jun Jung 10.8

KCC Corporation 8.1

Stock performance	1M	6M	12M
Absolute (%)	14.2	95.0	138.4
Relative to KOSPI (%p)	11.7	73.5	118.4

#### Price chart



### Non-shipbuilding in 2010, shipbuilding in 2011

#### Lift price target to W450,000

We maintain BUY and raise our price target from W330,000 (2011F PBR of 1.6x) to W450,000 (2011F PBR of 1.9x). We lifted the earnings estimates and ROE considering that Hyundai Heavy Industries (HHI) reorganized its shipbuilding schedule with high-priced orders delayed from 2008 added to the 2011-2012 works, lifting the shipbuilding ASP for 2011-2012. The stock price has recently seen a technical retreat due to an earlier jump (up 120% from early 2010). However, we recommend BUY on the dip, focusing on the expected turnaround at the shipbuilding and offshore divisions in 2011.

#### From non-shipbuilding to shipbuilding

For HHI, a key issue in 2010 was its non-shipbuilding strength. Non-shipbuilding projects contributed 78% of cumulative orders and 64% of sales in 3Q10. The shipbuilding orders totaled a mere USD3.1bn YTD-September, only half the full-year shipbuilding targeted sales in 2010, as HHI avoided low-priced orders. As the main ship orders are expected to switch from bulk carriers to high value-added (ultra-large containerships, etc.) in 2011, HHI will resume accepting orders with a bigger ASP. HHI has enough docks available compared to other shipbuilders and this will allow healthy margins with a price premium for early delivery.

#### Order momentum for high value-added and special ships expected

HHI is one of the strongest candidates to win the Brass LNG project (14 vessels) in Nigeria. HHI was not aggressive to pursue merchant ship orders such as bulk carriers or tankers but is now participating in the bid because LNG vessels are high value-added (>USD200mn per ship) and a probable string of orders will ensure big profitability. Furthermore, HHI will likely to put its name on the leader board in the bid to build 20 ultra-large containerships (contract value USD4bn) for Maersk, as HHI has ranked first in the segment with a market share of 45% (based on deliveries). The Wasit offshore gas field project (>USD1bn) will probably go to HHI, the world's top offshore facility builder. The order momentum from the high value-added and special ships will be the biggest catalyst for HHI's stock.

#### Drilling facility shortfall expected in 2012

We anticipate offshore facility orders in 2011 given the likely shortage of drilling vessels in 2012 and onward. The delivery of drilling facilities including drill ships should peak in 2011 and beginning in 2012, deliveries will plunge to half the present amount as orders were sluggish in the wake of the financial crisis.

#### JD Yang

822-3276-6175  
jd.yang@truefriend.com

#### JungMyoung Seo

822-3276-6189  
jmseo@truefriend.com

	Sales	OP	EBT	NP	EPS	% chg	EBITDA	P/E	EV/EBITDA	P/B	ROE
	(W bn)	(W bn)	(W bn)	(W bn)	(won)	(YoY)	(W bn)	(x)	(x)	(x)	(%)
2008A	19,957	2,206	2,950	2,257	37,340	34.4	2,597	5.3	4.3	2.2	40.7
2009A	21,142	2,223	2,648	2,146	35,705	(4.4)	2,668	4.9	4.4	1.2	27.9
2010F	21,448	3,221	4,392	3,560	58,509	63.9	3,743	6.7	8.1	2.1	31.0
2011F	24,220	3,374	4,519	3,663	60,431	3.3	3,929	6.5	7.3	1.7	24.6
2012F	26,469	3,246	4,248	3,443	56,801	(6.0)	3,837	6.9	7.4	1.4	18.9

Moreover, we believe Brazilian shipbuilders are unlikely to deliver drilling facilities on time to their domestic clients. It reminds us of when China's startup shipbuilders failed to deliver orders on time, which worked to mitigate the supply side pressure in the world's newbuilding market. It appears Brazil placed excessive orders to its domestic shipbuilders not because it trusted the technological ability of its domestics but due to political motives ahead of the presidential election in October. This indicates that once the deliveries are pushed back, offshore project orders will likely resume for the top-tier shipbuilders, including Korean.

### Valuation and risk

HHI trades at a 2011F PBR of 1.7x, which we see as appealing considering the bottoming-out of the shipbuilding industry and the 2011F ROE of 25%. We forecast the operating margin will resume its uptrend after passing a short-term trough in 2012, assuming newbuilding prices pick up in 2011. If ship orders do not grow and the newbuilding prices remain unchanged, it would pose a risk to investment.

### Earnings estimate changes

(W bn, %)

	2011F			2012F		
	Previous	Revised	Diff. (%)	Previous	Revised	Diff. (%)
Sales	22,965	24,220	5.5%	24,114	26,469	9.8%
Operating profit	3,051	3,374	10.6%	3,206	3,246	1.2%
OP margin	13.3%	13.9%		13.3%	12.3%	

Source: Korea Investment &amp; Securities

### Price target changes

(KRW, %, x)

	Previous	Revised	Diff. (%)
BPS (2011F)	207,904	233,440	12.3
ROE	20.5% (2010-2011F avg.)	24.6% (2011F)	
Target PBR	1.6	1.9	
Price target	330,000	450,000	36.4

Source: Korea Investment &amp; Securities

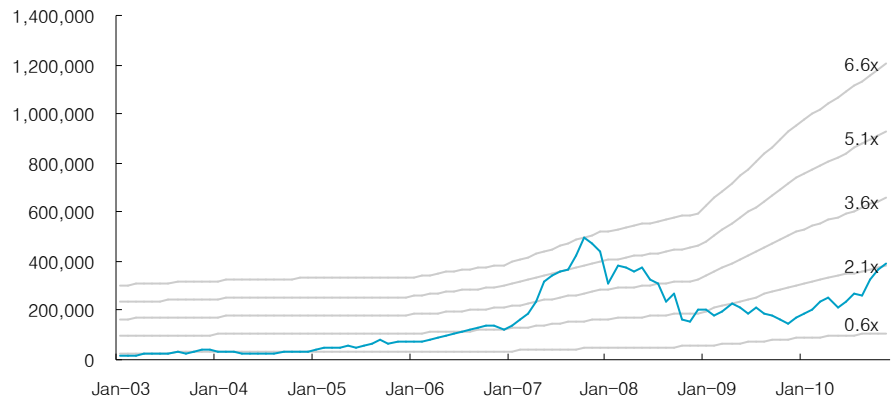
### Earnings by division

(W bn)

	2006	2007	2008	2009	2010F	2011F	2012F
Revenue	12,555	15,533	19,957	21,142	21,448	24,220	26,469
Shipbuilding	6,443	7,557	9,085	9,003	7,676	8,598	9,006
Offshore	1,935	2,222	3,095	3,424	3,295	3,954	4,671
Industrial plants	602	1,017	1,374	1,898	2,657	2,923	3,215
Engines/machinery	1,220	1,646	2,522	2,772	2,494	2,794	2,927
Electro-systems	1,056	1,453	1,924	2,712	3,065	3,463	3,913
Construction equipment	1,198	1,512	1,769	1,190	2,262	2,488	2,737
OP	879	1,751	2,206	2,223	3,221	3,374	3,246
Shipbuilding	504	1,038	1,067	532	1,145	1,196	803
Offshore	223	226	289	463	643	574	678
Industrial plants	98	130	113	246	678	703	678
Engines/machinery	206	346	614	809	481	544	654
Electro-systems	150	224	360	453	240	264	274
Construction equipment	(77)	40	17	(30)	292	351	418
OP margin	7.0%	11.3%	11.1%	10.5%	15.0%	13.9%	12.3%
Shipbuilding	7.8%	13.7%	11.7%	5.9%	14.9%	13.9%	8.9%
Offshore	11.5%	10.2%	9.3%	13.5%	19.5%	14.5%	14.5%
Industrial plants	16.3%	12.7%	8.2%	12.9%	25.5%	24.1%	21.1%
Engines/machinery	16.9%	21.0%	24.3%	29.2%	19.3%	19.5%	22.3%
Electro-systems	14.2%	15.4%	18.7%	16.7%	7.8%	7.6%	7.0%
Construction equipment	(6.5%)	2.7%	1.0%	(2.5%)	12.9%	14.1%	15.3%

Source: Company data, Korea Investment &amp; Securities

**12MF PBR**



Source: Korea Investment & Securities

**World drilling facilities**

(units)

		Drill ships	-submersibles	Semi Jack-ups	Submersibles	Drilling barges	Total
<b>In operation</b>	Before 2010	48	190	466	6	48	758
	Beginning in 2010	6	8	9	0	0	23
	Sub-total	54	198	475	6	48	781
<b>Under construction</b>	For 2010 delivery	8	10	16	0	0	34
	For 2011 delivery	17	12	12	0	0	41
	For 2012 delivery	6	8	8	0	0	22
	For 2013 delivery	2	0	0	0	0	2
	Sub-total	33	30	36	0	0	99
<b>Total</b>		87	228	511	6	48	880

Note: As of end-August.

Source: Operators' and Builders' SEC Filings and web sites, RigZone.com, Korea Investment & Securities

**Balance sheet**

Fiscal year ending Dec. (W bn)	2008A	2009A	2010F	2011F	2012F
Current assets	12,618	10,610	10,764	12,155	13,283
Cash & cash equivalents	667	633	642	725	792
Accounts receivable	4,499	4,974	5,046	5,698	6,227
Inventory	2,263	1,929	1,956	2,209	2,414
Non-current assets	12,663	14,263	14,666	15,782	16,747
Investments	3,224	4,866	4,937	5,575	6,092
Tangible assets	6,190	8,146	8,460	8,774	9,089
Intangible assets	262	288	293	330	361
<b>Total assets</b>	<b>25,280</b>	<b>24,873</b>	<b>25,429</b>	<b>27,937</b>	<b>30,030</b>
Current liabilities	16,474	12,909	10,089	8,901	7,564
Accounts payable	2,337	1,428	1,448	1,635	1,787
Short-term debt and bond	0	585	2,585	1,085	585
Current portion of LT debt	0	0	0	0	0
Non-current liabilities	3,211	2,155	2,184	2,428	2,627
Debentures	0	299	299	299	299
LT debt and lease	3	5	7	9	11
<b>Total liabilities</b>	<b>19,685</b>	<b>15,064</b>	<b>12,273</b>	<b>11,329</b>	<b>10,191</b>
Paid-in capital	380	380	380	380	380
Capital surplus	2,819	2,870	2,870	2,870	2,870
Capital adjustments	(1,762)	(1,698)	(1,698)	(1,698)	(1,698)
Retained earnings	4,657	6,504	9,852	13,303	16,535
Shareholders' equity	5,595	9,808	13,157	16,608	19,839

Source: Company data, Korea Investment &amp; Securities estimates

**Cash flow**

Fiscal year ending Dec. (W bn)	2008A	2009A	2010F	2011F	2012F
C/F from operations	2,383	(958)	(1,803)	2,321	1,488
Net profit	2,257	2,146	3,560	3,663	3,443
Depreciation	347	400	474	503	533
Amortization	43	46	49	52	58
Net incr. in W/C	(1,235)	(5,608)	(4,963)	(982)	(1,886)
Others	970	2,058	(922)	(916)	(660)
C/F from investing	(1,184)	337	32	(706)	(849)
Capex	(1,791)	(1,179)	(775)	(818)	(848)
Decr. in fixed assets	83	128	0	0	0
Net incr. in current assets	870	1,700	(2)	(14)	(12)
Incr. in investment	(279)	(249)	875	342	201
Others	(67)	(63)	(67)	(216)	(191)
C/F from financing	(1,485)	586	1,780	(1,532)	(572)
Incr. in equity	0	0	0	0	0
Incr. in debt	(186)	886	1,969	(1,531)	(531)
Dividends	(467)	(300)	(212)	(212)	(212)
Others	(833)	0	23	211	172
<b>Increase in cash</b>	<b>(286)</b>	<b>(35)</b>	<b>9</b>	<b>83</b>	<b>67</b>

Source: Company data, Korea Investment &amp; Securities estimates

**Income statement**

Fiscal year ending Dec. (W bn)	2008A	2009A	2010F	2011F	2012F
Sales	19,957	21,142	21,448	24,220	26,469
Gross profit	3,145	3,145	4,337	4,631	4,618
SG&A expenses	939	922	1,116	1,257	1,372
Operating profit	2,206	2,223	3,221	3,374	3,246
Non-operating profit	3,827	3,310	3,853	3,857	3,648
Interest income	280	167	152	83	92
FX gains	818	749	749	749	749
Equity gains	771	480	1,097	1,132	870
Non-operating expenses	3,084	2,884	2,681	2,712	2,646
Interest expenses	6	34	145	164	87
FX losses	762	607	607	607	607
Equity losses	152	195	152	152	152
Earnings before tax	2,950	2,648	4,392	4,519	4,248
Income taxes	693	502	832	856	805
Profit from discontinued op.	0	0	0	0	0
Net profit	2,257	2,146	3,560	3,663	3,443
EBITDA	2,597	2,668	3,743	3,929	3,837

Source: Company data, Korea Investment &amp; Securities estimates

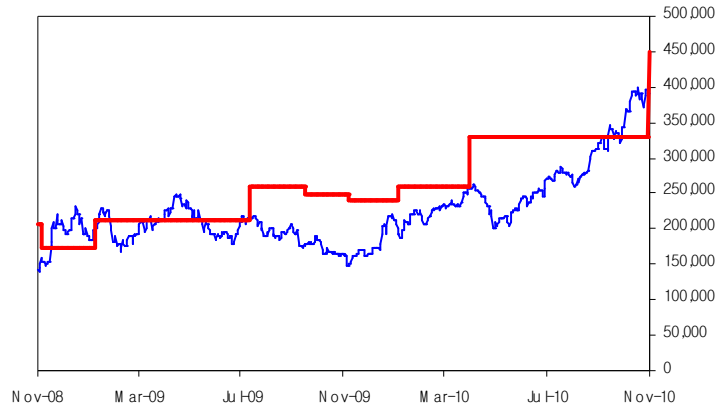
**Key financial data**

Fiscal year ending Dec.	2008A	2009A	2010F	2011F	2012F
Per-share data (won)					
EPS	37,340	35,705	58,509	60,431	56,801
BPS	90,294	144,525	188,526	233,440	275,551
DPS	5,000	3,500	3,500	3,500	3,500
SPS	330,221	351,682	352,462	399,535	436,627
Growth (%)					
Sales growth	28.5	5.9	1.4	12.9	9.3
OP growth	26.0	0.7	44.9	4.8	(3.8)
NP growth	30.0	(4.9)	65.9	2.9	(6.0)
EPS growth	34.4	(4.4)	63.9	3.3	(6.0)
EBITDA growth	21.2	2.7	40.3	5.0	(2.4)
Profitability (%)					
OP margin	11.1	10.5	15.0	13.9	12.3
NP margin	11.3	10.2	16.6	15.1	13.0
EBITDA margin	13.0	12.6	17.5	16.2	14.5
ROA	10.7	8.6	14.2	13.7	11.9
ROE	40.7	27.9	31.0	24.6	18.9
Dividend yield	2.5	2.0	0.9	0.9	0.9
Stability					
Net debt (W bn)	(2,473)	148	2,139	544	(33)
Int. coverage (x)	340.9	65.1	22.3	20.6	37.1
D/E ratio (%)	0.1	9.1	22.0	8.4	4.5
Valuations (x)					
PER	5.3	4.9	6.7	6.5	6.9
PBR	2.2	1.2	2.1	1.7	1.4
PSR	0.6	0.5	1.1	1.0	0.9
EV/EBITDA	4.3	4.4	8.1	7.3	7.4

Source: Company data, Korea Investment &amp; Securities estimates

**Changes to recommendation and price target**

Company (Code)	Date	Recommendation	Price target
Hyundai Heavy Industries(009540)	11-28-08	Hold	W172,000
	01-30-09	Hold	W211,000
	08-03-09	BUY	W260,000
	10-09-09	BUY	W250,000
	11-30-09	BUY	W240,000
	01-27-10	BUY	W260,000
	04-23-10	BUY	W330,000
	11-23-10	BUY	W450,000



■ **Guide to Korea Investment & Securities Co., Ltd. stock ratings based on absolute 12-month forward share price performance**

- BUY: Expected to give a return of +15% or more
- Hold: Expected to give a return between -15% and 15%
- Underweight: Expected to give a return of +15% or less

■ **Guide to Korea Investment & Securities Co., Ltd. sector ratings for the next 12 months**

- Overweight: Recommend increasing the sector's weighting in the portfolio compared to its respective weighting in the Kospi (Kosdaq) based on market capitalization.
- Neutral: Recommend maintaining the sector's weighting in the portfolio in line with its respective weighting in the Kospi (Kosdaq) based on market capitalization.
- Underweight: Recommend reducing the sector's weighting in the portfolio compared to its respective weighting in the Kospi (Kosdaq) based on market capitalization.

■ **Analyst Certification**

I/We, as the research analyst/analysts who prepared this report, do hereby certify that the views expressed in this research report accurately reflect my/our personal views about the subject securities and issuers discussed in this report. I/We do hereby also certify that no part of my/our compensation was, is, or will be directly or indirectly related to the specific recommendations or views contained in this research report.

■ **Important Disclosures**

As of the end of the month immediately preceding the date of publication of the research report or the public appearance (or the end of the second most recent month if the publication date is less than 10 calendar days after the end of the most recent month), Korea Investment & Securities Co., Ltd., or its affiliates does not own 1% or more of any class of common equity securities of Hyundai Heavy Industries.

There is no actual, material conflict of interest of the research analyst or Korea Investment & Securities Co., Ltd., or its affiliates known at the time of publication of the research report or at the time of the public appearance.

Korea Investment & Securities Co., Ltd., or its affiliates has not managed or co-managed a public offering of securities for Hyundai Heavy Industries in the past 12 months;

Korea Investment & Securities Co., Ltd., or its affiliates has not received compensation for investment banking services from Hyundai Heavy Industries in the past 12 months; Korea Investment & Securities Co., Ltd., or its affiliates does not expect to receive or intends to seek compensation for investment banking services from Hyundai Heavy Industries in the next 3 months.

Korea Investment & Securities Co., Ltd., or its affiliates was not making a market in Hyundai Heavy Industries's securities at the time that the research report was published.

Korea Investment & Securities Co., Ltd. does not own over 1% of Hyundai Heavy Industries shares as of November 23, 2010.

Korea Investment & Securities Co., Ltd. has not provided this report to various third parties.

Neither the analysts covering these companies nor their associates own any shares of as of November 23, 2010.

Korea Investment & Securities Co., Ltd. has issued ELW with underlying stocks of Hyundai Heavy Industries and is the liquidity provider.

Prepared by: JD Yang, JungMyoung Seo

This report was written by Korea Investment & Securities Co., Ltd. to help its clients invest in securities. This material is copyrighted and may not be copied, redistributed, forwarded or altered in any way without the consent of Korea Investment & Securities Co., Ltd. This report has been prepared by Korea Investment & Securities Co., Ltd. and is provided for information purposes only. Under no circumstances is it to be used or considered as an offer to sell, or a solicitation of any offer to buy. We make no representation as to its accuracy or completeness and it should not be relied upon as such. The company accepts no liability whatsoever for any direct or consequential loss arising from any use of this report or its contents. The final investment decision is based on the client's judgment, and this report cannot be used as evidence in any legal dispute related to investment decisions.