

Hyundai Heavy Industries (009540/BUY)

SELL HOLD **BUY**

Target price **KRW376,000**
Upside/downside **+2.5%**
Current price **KRW367,000**



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■ AT A GLANCE

Business summary: The world's largest shipbuilder, Hyundai Heavy Industries produces commercial and specialized vessels, as well as heavy machinery.

Sector	Shipbuilding		
Market capitalization	KRW27.9t/USD24.9b		
Shares outstanding (float)	76,000,000	(58.5%)	
52-week high/low	KRW374,000/KRW147,500		
Bloomberg	009540 KS		
60-day average volume	309,125		
Share ownership	MJ Chung (10.8%)		
Performance	1M	6M	12M
Absolute	+11.7%	+40.1%	+115.9%
Relative	+9.2%	+31.0%	+98.2%

SUMMARY OF 3Q RESULTS

(KRWb)	3Q10	Chg		Diff (%)	
		(% y-y)	(% q-q)	Samsung	Consensus
Sales	5,334	7.0	(0.0)	0.6	1.5
Operating profit	799	50.2	3.6	5.0	10.6
Pre-tax profit	1,073	53.5	(8.6)	8.1	14.1
Net profit	863	61.7	(5.2)	11.6	21.8
Margins (%)					
Operating profit	15.0	4.3	0.5	0.6	1.2
Pre-tax profit	20.1	6.1	(1.9)	1.4	2.2
Net profit	16.2	5.5	(0.9)	1.6	2.7

Source: Company data, Samsung Securities estimates

■ RESULTS NOTE

Shipbuilding sales to slow, but diversity to protect profits

One-off spec changes in offshore and plant divisions solidify 3Q results

Hyundai Heavy Industries (HHI) yesterday reported 3Q sales of KRW5.3t and operating profit of KRW799b, the latter beating consensus by 11%, which we attribute to one-off specification changes in the offshore and plant divisions.

Sales from shipbuilding-related business slow

Excluding the offshore business, HHI's shipbuilding and engine sales have fallen y-y for five quarters running. We estimate that the operating margin of the shipbuilding division has decreased at least 1-2%pts from 18% in 1Q10, due mainly to a decline in high-margin bulk carrier orders taken over 2007-2008—when prices for the vessels reached historic highs—in its order book. According to Clarkson Research, the company received 33 such orders, delivering 2 vessels in 2009 and 10 over Jan-Sep 2010. Six vessels are scheduled to be delivered in 4Q, and 15 next year. Although we estimate that the engine division's operating margin remains solid at above 25%, we believe the business's operating profit fell more than 15% y-y in 3Q.

We believe HHI's shipbuilding-related sales will decline from 2H11. For reference, we estimate that the shipbuilding and engine divisions contributed a respective 35% and 15% of the firm's sales and a combined 51% of its operating profit over Jan-Sep 2010.

Diversity to protect profitability

HHI has secured 80% of 2010 new order target of USD17.7b. While the shipbuilding and offshore divisions have won just USD5.8b, or 70% of their target, we believe solid non-shipbuilding orders allowed HHI to avoid taking low-priced shipbuilding orders in 1H. This should allow it to protect its profitability and slow deterioration in its sales and margins better than its rivals going forward.

Maintaining BUY rating and target price

HHI shares have jumped 12% in the past week on expectations that the firm will win new orders for large containerships. We believe, however, that visibility on the sustainability of containership order volumes will not be possible until after 1Q11, as seasonality could trigger an increase in idled vessel capacity in the near term. We plan to maintain our 12-month target price of KRW376,000 on HHI until signs of meaningful new order momentum appear.

VALUATION SUMMARY

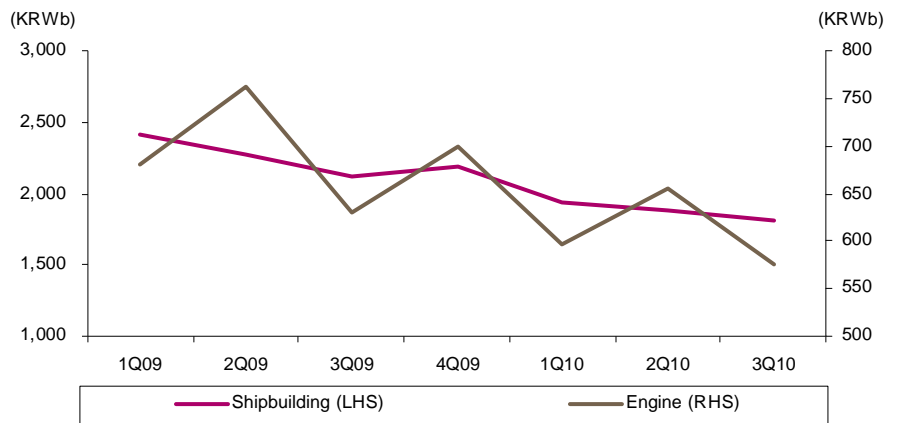
	2010E	2010E	2011E
Multiples (x)			
P/E	8.3	11.2	14.1
P/B	2.3	2.0	1.8
EV/EBITDA	6.4	7.8	9.6
Div yield (%)	1.0	1.0	1.0
EPS growth (%)	79.8	(26.2)	(20.9)
ROE (%)	30.9	19.0	13.4
Per share data (KRW)			
EPS	44,464	32,809	25,938
BVPS	159,100	185,963	202,602
DPS	3,500	3,500	3,500

Table 1. New orders, by divisions

(USDm)	2010 guidance (A)	1Q-3Q new orders (B)	Reach (C = B/A, %)
Shipbuilding	4,030	3,073	76.3
Offshore	4,200	2,726	64.9
Plant	2,000	1,897	94.9
Engines	2,300	1,849	80.4
Electronic systems	3,636	2,921	80.3
Construction equipment	1,559	1,509	96.8
Total	17,725	13,975	78.8

Source: Company data

Chart 1. Shipbuilding and engine sales trends



Source: Company data

Income statement

Year-end Dec 31 (KRWb)	2008	2009	2010E	2011E	2012E
Sales	19,957	21,142	21,348	21,623	20,896
Manufactured goods	19,957	21,142	21,348	21,623	20,896
Merchandise and other	0	0	0	0	0
Cost of goods sold	16,812	17,997	17,092	17,432	17,556
Manufactured goods	16,812	17,997	17,092	17,432	17,556
Merchandise and other	0	0	0	0	0
Gross profit	3,145	3,145	4,257	4,190	3,340
SG&A expenses	939	922	1,047	1,170	1,092
Labor costs	367	376	403	435	470
Depreciation	32	39	40	41	41
Other	539	507	605	694	582
Operating profit	2,206	2,223	3,209	3,020	2,248
Non-operating income	3,827	3,310	2,760	1,633	1,698
Interest income	289	175	141	171	212
Forex gains	818	749	70	70	70
Other	2,720	2,386	2,549	1,392	1,415
Non-operating expenses	3,084	2,884	1,639	1,358	1,347
Interest expenses	6	34	150	238	238
Forex losses	762	607	95	95	95
Other	2,315	2,243	1,394	1,024	1,013
Pre-tax profit	2,950	2,648	4,330	3,295	2,598
Taxes	693	502	974	824	650
Net profit	2,257	2,146	3,356	2,471	1,949
EBITDA	2,554	2,622	4,783	3,823	3,084
EPS (KRW)*	29,409	24,726	44,464	32,809	25,938

Cash flow

Year-end Dec 31 (KRWb)	2008	2009	2010E	2011E	2012E
Operating cash flow	2,383	(958)	1,303	1,365	932
Net profit	2,257	2,146	3,356	2,471	1,949
Depreciation	385	451	482	495	487
Severance payments	61	(26)	78	70	59
Forex losses (gains)	(21)	33	30	30	30
Associate losses (gains)	(620)	(285)	(750)	(530)	(530)
Chg in working capital	(251)	(2,928)	(1,893)	(1,172)	(1,063)
Other	572	(349)	0	0	0
Investment cash flow	(1,184)	337	(3,597)	(402)	(388)
Capex	(1,889)	(1,271)	(755)	(562)	(543)
Free cash flow	(1,573)	(543)	2,855	2,147	1,315
Chg in investment assets	(276)	(253)	(2,475)	25	25
Other	981	1,861	(367)	135	130
Financing cash flow	(1,485)	586	2,250	(266)	(266)
Chg in short-term debt	0	585	2,415	0	0
Chg in long-term debt	2	2	0	0	0
Chg in bonds	0	299	101	0	0
Chg in current maturities	(187)	0	0	0	0
Dividends	(467)	(300)	(266)	(266)	(266)
Rights issues	0	0	0	0	0
Other	(833)	(0)	0	0	0
Adjustments	0	0	0	0	0
Chg in cash	(286)	(35)	(45)	696	278
Cash at beg of year	954	667	633	588	1,284
Cash at end of year	667	633	588	1,284	1,562

Note: * Fully diluted, excluding one-off items

Source: Company data, Samsung Securities estimates

Balance sheet

Year-end Dec 31 (KRWb)	2008	2009	2010E	2011E	2012E
Current assets	12,618	10,610	10,621	10,863	10,950
Cash & equivalents	667	633	588	1,284	1,562
Financial goods	1,676	109	109	199	275
Marketable securities	102	0	0	0	0
Accounts receivable	4,499	4,974	5,381	5,213	5,153
Inventories	2,263	1,929	1,638	1,659	1,546
Other current assets	3,409	2,966	2,906	2,508	2,415
Non-current assets	12,663	14,263	16,827	16,631	16,487
Investment assets	3,224	4,866	7,337	7,308	7,279
Tangible assets	6,190	8,146	8,329	8,302	8,258
Intangible assets	262	288	270	270	270
Other	2,986	962	890	750	680
Total assets	25,280	24,873	27,448	27,494	27,437
Current liabilities	16,474	12,909	13,459	11,692	10,412
Accounts payable	2,337	1,428	1,462	1,422	1,145
Short-term borrowings	0	585	3,000	3,000	3,000
Current portion of long-term debt	0	0	0	0	0
Other current liabilities	14,137	10,896	8,997	7,271	6,267
Non-current liabilities	3,211	2,155	1,898	1,668	1,627
Bonds	0	299	400	400	400
Long-term debt	3	5	5	5	5
Other long-term liabilities	3,208	1,851	1,492	1,263	1,222
Total liabilities	19,685	15,064	15,357	13,360	12,039
Capital stock	380	380	380	380	380
Capital surplus	2,819	2,870	2,921	2,972	3,023
Retained earnings	4,657	6,504	9,594	11,799	13,482
Capital adjustments	(1,762)	(1,698)	(1,779)	(1,895)	(1,960)
Other comprehensive income	(498)	1,753	977	878	474
Total equity	5,595	9,808	12,092	14,133	15,398

Financial ratios

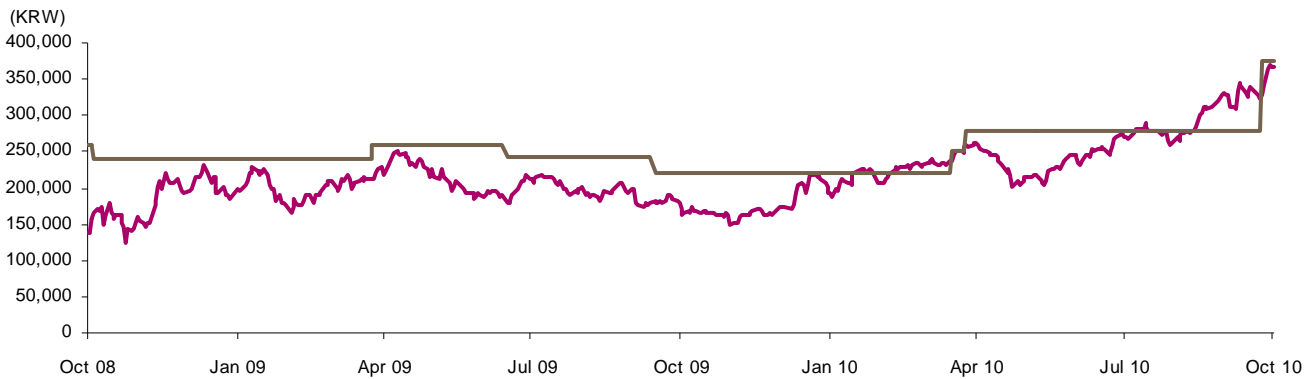
Year-end Dec 31	2008	2009	2010E	2011E	2012E
Growth (% y-y)					
Sales	28.5	5.9	1.0	1.3	(3.4)
Operating profit	26.0	0.7	44.4	(5.9)	(25.6)
Pre-tax profit	23.2	(10.2)	63.5	(23.9)	(21.1)
Net profit	30.0	(4.9)	56.3	(26.4)	(21.1)
EBITDA	21.5	2.7	82.4	(20.1)	(19.3)
EPS*	28.0	(15.9)	79.8	(26.2)	(20.9)
Margins (%)					
Operating profit	11.1	10.5	15.0	14.0	10.8
Pre-tax profit	14.8	12.5	20.3	15.2	12.4
Net profit	11.3	10.2	15.7	11.4	9.3
EBITDA	12.8	12.4	22.4	17.7	14.8
ROE	40.3	24.4	30.9	19.0	13.4
ROA	10.7	8.6	12.8	9.0	7.1
Ratios					
Net debt/equity (%)	nc	1.5	22.4	13.6	10.2
Liabilities/equity (%)	351.8	153.6	127.0	94.5	78.2
Interest coverage (x)	nm	nm	336.4	44.8	86.0
Receivables turnover (x)	5.5	4.5	4.1	4.1	4.0
Per share data (KRW)					
Sales	262,593	278,187	280,900	284,508	274,952
Book value	73,621	129,058	159,100	185,963	202,602
Dividend	5,000	3,500	3,500	3,500	3,500
Payout (%)	13.3	12.4	7.9	10.8	13.6
EBITDA	33,599	34,504	62,934	50,302	40,580

Hyundai Heavy Industries

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■ Target price changes in past two years



■ Rating changes in past two years

Date	2008/10/31	2009/4/30	7/13	10/13	2010/1/13	3/10	4/13	4/23	10/21	10/21
Recommendation	BUY(M)	BUY(M)	BUY(M)	BUY(M)	BUY	BUY★☆☆	BUY★☆☆	BUY★☆☆	BUY★☆☆	BUY
Target price (KRW)	240,000	260,000	243,000	220,000	220,000	220,000	250,000	280,000	376,000	376,000

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Industry

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Hyundai Heavy Industries

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