18 Nov 2009

KOREA

Hyundai Heavy Industries

Hyundai Oilbank acquisition price is slightly higher than market price

BUY	Maintain
W165,500	Target: W210,000
	Mkt.Cap: W12.58tn/US$10.89bn
	Industrial Machinery

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Maintain BUY and TP of W210,000

We reiterate the BUY rating and TP of W210,000 for Hyundai Heavy Industries. Although we carry a somewhat negative view on the forthcoming acquisition of Hyundai Oilbank, the BUY rating remains intact, based on: 1) Hyundai Heavy Industries could receive gains from the possible resale of Hyundai Oilbank; 2) Valuation appeal caused by recent declines in the company's stock price. However, over the short term, we believe there is insufficient momentum for a stock price rebound.

Acquisition price is slightly higher than market price

Having won the arbitration against IPIC, former Hyundai Group subsidiaries that have a stake in Hyundai Oilbank, which includes Hyundai Heavy Industries, will acquire a 70% stake in Hyundai Oilbank at a total of W2.57tn, or W15,000 per share. P/E of 11.0x, P/B of 2.1x and EV/EBITDA of 9.4x are applied to the 2009 earnings estimate of Hyundai Oilbank. The acquisition price is slightly higher than the current market price. The average valuation indexes for listed peers (S-Oil, SK Energy) in Korea are: P/E of 11.8x, P/B of 1.6x and EV/EBITDA of 8.8x).

The scheduled takeover of Hyundai Oilbank should have a neutral impact on Hyundai Heavy Industries earnings. Equity method gains and goodwill amortization expenses should offset the majority of interest expenses incurred from the external financing of the entire W2.57tn. As a result, the potential acquisition will have little impact on the company's pre-tax profits.

However, the cash borrowing process will negatively impact the company's finances. At end-3Q09, Hyundai Heavy Industries became a net debtor. Consequently, the company should rely on external borrowings to fund the acquisition. If Hyundai Heavy Industries decides to maintain its stake in Hyundai Oilbank, heavy investment in sophisticated facilities will be required, in upwards of an estimated W1.5tn. The additional cash outflows would weigh heavily on the company's stock price.

Resale of Hyundai Oilbank shares to be a bullish factor for Hyundai Heavy Industries

If Hyundai Heavy Industries decides to sell its managerial rights stake in Hyundai Oilbank to a third party, the resale would be beneficial for Hyundai Heavy Industries: We believe the company would be able to reap gains from the resale thanks to the premium associated with the management rights. However, as the takeover of Hyundai Oilbank has just been confirmed, we believe contemplation of a potential re-sale would be premature.

Earnings trend and acquisition price valuation- acquisition price is slightly higher than average market price (units: Wbn, x, %)

	Category	2005	2006	2007	2008	2009F	2009H1
Earnings trend	Sales	7,916	9,170	9,458	14,766	n.a.	4,941
	OP	399	137	429	62	362	301
	%	5.0%	1.5%	4.5%	0.4%	n.a.	6.1%
	EBITDA	558	314	605	248	546	393.7
	Pre-tax NP	374	98	294	(335)	417	348
	NP	277	68	198	(254)	334	278
	%	3.5%	0.7%	2.1%	-1.7%	n.a.	5.6%
Acquisition price valuation	Acquisition price (a 70% stake)		W2.57tn (W 15,000/share)				
	Acquisition price (converted to 100%)		W3.671tn				
	Applied P/E	13.2	53.6	18.5	-14.4	**11.0**	
	Applied P/B	2.4	2.5	2.2	2.5	**2.1**	
	Applied EV/EBITDA	6.6	11.7	7.4	20.8	**9.4**	

Note: Based on the assumption that Hyundai Oilbank 2H09 NP is 20% of 1H09 NP; On average, P/E of 11.8x, P/B of 1.6x and EV/EBITDA of 8.8x are applied to listed oil refining companies (S-Oil, SK Energy)
Source: Hyundai Oilbank, Daishin Securities Research Center

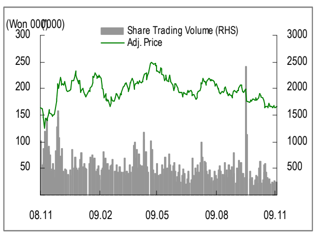
Takeover of Hyundai Oilbank to have an insignificant impact on Hyundai Heavy Industries earnings

	Category	Amount (Wbn, %)
Goodwill amortization expenses	Acquisition price	2,573
	Estimated book value as of end-2009	1,800
	Goodwill amortization	1,313
	Annual goodwill amortization amount (20 yrs) [A]	66
Equity method gains	2009 NP estimate	334
	Equity method gains[B]	234
	Subtract goodwill amortization amount [C=B-A]	168
Annual interest expenses	Annual interest rate	6%
	Annual interest expenses[D]	154
Impact on pre-tax profit	Chg. in annual pre-tax profit[C-D]	**14**
	Chg. in EPS (W/share)	**136**

Source: Daishin Securities Research Center

If Hyundai Heavy Industries re-sells its entire 70% stake in Hyundai Oilbank, the company will receive W518bn in gains from the transaction. The W518bn amount was calculated by subtracting the acquisition cost of W2.57tn from the selling price of W3.088tn. Valuation indexes for listed peers include S-Oil and SK Energy (P/E of 12x and P/B of 1.6x), in addition to the application of a 30% premium associated with the management rights.

Price chart



Source: Bloomberg

Financial summary

FYE Dec	2007	2008	2009F	2010F	2011F
Revenue (Won bn)	15,533.0	19,957.1	21,119.8	22,464.2	21,350.0
EBITDA (Won bn)	2,142.6	2,597.0	2,499.2	2,965.5	2,135.2
EBITDA margins (%)	13.8	13.0	11.8	13.2	10.0
Pretax profit (Won bn)	2,394.4	2,949.6	2,455.4	3,144.8	2,235.1
Net profit (Won bn)	1,736.1	2,256.7	1,861.2	2,383.8	1,694.2
EPS (Won)	22,843	29,693	24,490	31,365	22,292
EPS growth (%)	143.5	30.0	-17.5	28.1	-28.9
P/E (x)	19.4	6.7	7.2	5.6	7.9
FD core EPS (Won)	22,843	29,693	24,490	31,365	22,292
FD core P/E (x)	19.4	6.7	7.2	5.6	7.9
Gross DPS (Won)	7,500	5,000	5,000	5,000	5,000
Dividend yield (%)	1.7	2.5	2.8	2.8	2.8
P/BV (x)	6.1	2.7	1.9	1.4	1.2
ROE (%)	35.4	40.7	29.2	29.1	16.5
Net gearing (%)	197.5	356.6	283.9	199.3	137.3
EV/EBITDA (x)	14.3	4.9	5.0	4.1	5.1
Change in EPS estimates			0.0	0.0	0.0
Daishin/Consensus (x)			-	-	-

Source: Company, Daishin Research, Bloomberg

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- Buy: the stock is expected to outperform the market by at least 10%p over the next six months.
- Marketperform: the stock is expected to either outperform or underperform the market by less than 10%p over the next six months.
- Underperform: the stock is expected to underperform the market by at least 10%p over the next six months.

▶ Sector ratings breakdown
- Overweight : industry indicators are expected to outperform the market over the next 6m
- Neutral : industry indicators are expected to be in line with the market over the next 6m
- Underweight: industry indicators are expected to underperform the market over the next 6ms.

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

Date	09.11.17	09.11.17	09.11.14	09.11.11	09.10.30	09.07.27	09.07.02	09.05.14	09.05.04	09.01.30	09.01.08
Rating	Buy	Buy	Buy	Buy	Buy	Buy	Buy	Buy	Buy	Buy	Buy
TP	210,000	210,000	210,000	210,000	235,000	262,000	262,000	262,000	262,000	262,000	0
Date	08.11.16	08.10.31	08.10.31	08.08.29	08.05.14	08.05.13	08.04.29	08.03.18	08.03.03		
Rating	Buy	Buy	Buy	Buy	Buy	Buy	Buy	Buy	Buy		
TP	211,000	211,000	211,000	444,000	444,000	444,000	444,000	444,000	444,000