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WHAT'S NEW

2Q09 results – strong stability

Hyundai Heavy Industries (HHI) reported 2Q09 results with 10.0% OP margin, up from 8.6% in 1Q09. Most business units showed stable operations with positive margins across all units. Profitability was stronger and more stable than peers. We expect stronger cash positions from the company going forward in light of normalizing account receivables and lower steel prices. Considering the general recovery of the industry as whole, we expect HHI to maximize its early and timely shipbuilding delivery slots. We maintain our Buy rating on the stock and a target price of W330,000.

» Stable business structure reconfirmed

» Stronger cash position outlook

» Cutting our aggressive earnings estimates by 20%

» Biggest beneficiary of recovery, maintain Buy at a target price of W330,000

Stable business structures reconfirmed

The company managed a sound recovery of its operational profitability in 2Q09, with an OP margin of 10.0%. While its shipbuilding unit continued to have low-single-digit margins hurt by highly priced heavy plate inventories, the company successfully offset the margin contraction through strong profitability from its non-shipbuilding units, such as its engine and electro electric units, and also by a turnaround by the plant engineering & construction equipment unit in 2Q09.

HHI's diversified business structure has resulted in relatively stronger and more stable profitability than peers. Strong cash flows also helped it maintain its bargaining power over its customers, the ship owners. The company relies on its shipbuilding unit for over 50% of sales; but the reason it is able to negotiate favourable contracts with its customers is that it is supported by its thriving non-shipbuilding units.

IMPACT

Hedge fund investors

The company is likely to show structural margin improvements as well as new order momentum going forward. HHI appears to be crawling out from its position at the bottom of the industry.

Long-only investors

We expect HHI to show outstanding profitability from its flexible production lines. Its profit-focused strategy is not well known, but the company will prove itself with its outstanding margin structures.

Target price **₩330,000**Current price (24 July 2009) **₩218,500**

Upside/downside 51.0%

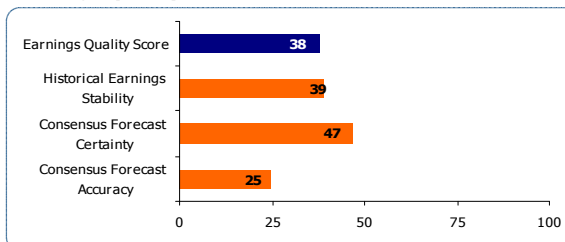
Consensus target price **₩262,000**

Difference from consensus 25.9%

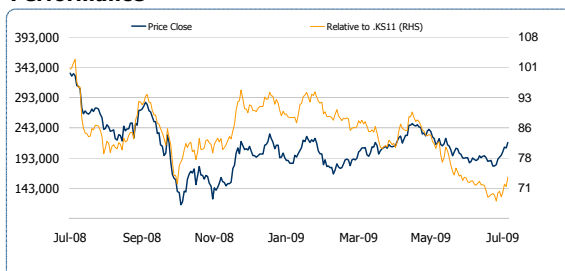
Forecast earnings & valuation

Fiscal year ending	Dec-08A	Dec-09E	Dec-10E	Dec-11E
Revenue (KRWb)	19,957	22,474	25,026	26,995
Op EBIT (KRWb)	2,206	2,750	3,522	3,841
Net income (KRWb)	2,604	2,829	3,472	3,849
Norm profit (KRWb)	2,257	2,522	3,308	3,707
EPS (KRW)	29,693	33,183	43,522	48,780
EPS growth	30.0%	11.8%	31.2%	12.1%
Norm P/E (x)	7.36	6.58	5.02	4.48
EV/EBITDA (x)	4.15	4.19	3.44	2.41
Dividend yield	2.29%	2.29%	3.43%	3.43%
P/B (x)	2.11	1.66	1.30	1.05
ROE	37.5%	31.7%	30.5%	26.9%
Net debt/equity (43.7%)	(21.5%)	(13.4%)	(36.3%)	
Cons EPS (KRW)	29,693	31,694	39,983	40,361
Prev EPS (KRW)	22,843	29,693	41,935	54,072

Earnings quality score



Performance



Trading data

Market cap (₩bn/US\$mn)	16,606/13,278		
Shares outstanding	76.00mn		
Free float	57.5%		
52-week price high/low	₩115,500 – 333,000		
Daily average turnover (3M)	US\$76.50mn		
Performance	1M	3M	12M
Absolute	16.8%	-3.8%	-34.4%
Relative to KOSPI	14.8%	-6.5%	-19.9%
Absolute (US\$)	15.6%	-0.1%	-48.7%
Major shareholders			
MJ Chung	10.8%		
Hyundai Mipo	8%		

See the last page of this report for important disclosures

Source for data: Company, Thomson Reuters, Mirae Research estimates

HHI signed no shipbuilding contracts in 1H09. Globally, shipbuilding orders shrank dramatically in 1H09, and thus opportunities were limited. HHI has the most competitive cost structure based heavily on its vertically integrated business unit and scale, which is several times larger than its peers. This situation gave the company a certain degree of leverage when negotiating for contracts – they did not have to act out of desperation as they were not completely dependent on the shipbuilding unit. The company could opt to hold out for better deals.

Figure 1. HHI 2Q09 results (Wbn)

	Actual			% Growth		Market	
	2Q09	1Q09	2Q08	QoQ	YoY	2Q09E	Diff
Sales	5,331.0	5,493.6	4,709.0	-3.0%	13.2%	5,541.0	-3.8%
OP	534.7	471.4	547.5	13.4%	-2.3%	574.8	-7.0%
NP	393.0	498.3	655.2	-21.1%	-40.0%	534.0	-26.4%
Margin(%)							
OPM	10.0%	8.6%	11.6%	1.4%pt	-1.6%pt	10.4%	-0.3%pt
NPM	7.4%	9.1%	13.9%	-1.7%pt	-6.5%pt	9.6%	-2.3%pt

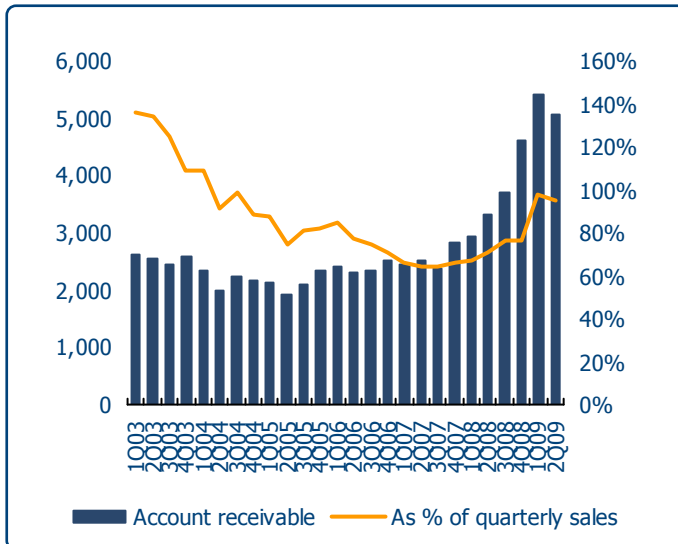
Source: Company data, Mirae Asset Research

Stronger cash position outlook

The company had rapidly deteriorating cash positions for the past several quarters, even in 2Q09. Towards 3Q09, we expect rapid normalization of its cash balances. This would clear up some of the concern over whether or not the company would rush to sign low-priced contracts for survival. As things stand, HHI has considerable bargaining power backed by its strong cash positions.

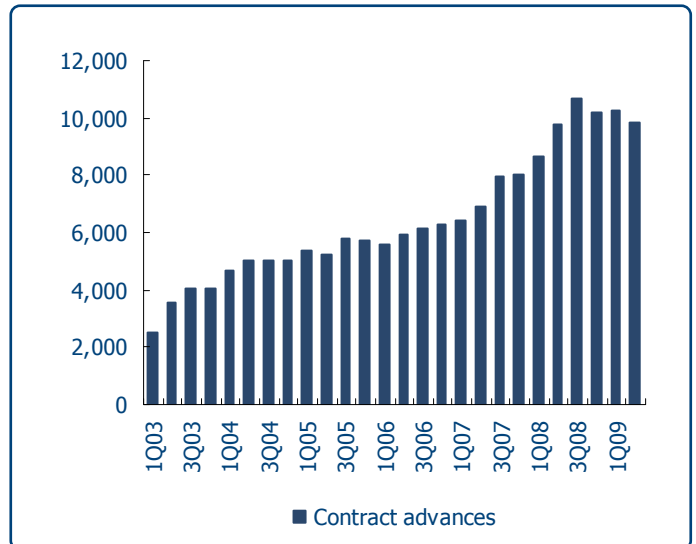
Greater possibility of stabilizing cash flows

Figure 2. Accounts receivable and % of quarterly revenue (Wbn)



Source: Company data, Mirae Asset Research

Figure 3 Trends of HHI's contract advances (Wbn)



Source: Company data, Mirae Asset Research

The key reason for HHI's falling cash balances was not a lack of new orders, but increased account receivables amid the financial crisis, coupled with the rapid growth of the business. HHI's account receivables increased to W5.4tn in 1Q09 but were later reduced to W5.1tn in 2Q09. Balances of account receivables amounted to 98% of quarterly revenue, but later began to normalize to 95%. Sharp increases in the balances were a short-lived phase, in our view.

Another positive catalyst for HHI's stronger cash balances is likely to be the sharp fall of heavy plate prices from 3Q09. Like other shipbuilders, HHI suffered from high-priced heavy plate inventories until mid-2Q09. As a result, it could not show strong profitability in its shipbuilding unit. From 3Q09, all of HHI's high-priced plate inventories were cleared, and showed typical margins based on current steel prices. These fell by about 30-40% from previous quarters.

Contract advances did not change much despite an absence of shipbuilding contracts YTD. While shipbuilding unit contracts fell to zero, the company had US\$3.4bn contracts from non-shipbuilding units. Indeed, HHI has secured its highest amount contracts since 2007, and thus the delivery of ships contracted before had limited impact on the balance as well. The balance of advances soared to W10.7tn in 3Q08, and slowed to W9.8tn in 2Q09. The current level of advances is well above the average for the past several years.

Cutting our aggressive earnings estimates

We had rather aggressive estimates on the earnings outlook of the company based on: 1) our assumption of a rapid depletion of high-priced heavy plate inventories, and 2) the continued operational strength of its affiliates. Meanwhile, the high-priced steel inventory burden continued until May, and the company had a lower profit contribution from equity method gains. Thus we lowered our earnings estimates by 20.9% for 2009E and by 19.5% for 2010E.

If our estimates prove correct the company will show better-than-expected sales growth toward 2011, considering the sharp sales growth of its electro electric unit. Our revenue forecast has been largely unchanged until 2010 but we revise it now despite some delayed ship delivery schedules. We have also raised our revenue estimates from 2011.

Cutting estimates by 20.9% for 2009E and by 19.5% for 2010E

Figure 4 Earnings changes

(Wbn)	09E	10E	11E	12E	13E
Sales	22,474.5	25,026.5	26,995.5	28,169.9	29,396.6
Old estimates	23,307.1	25,063.8	25,984.0	26,172.3	26,602.8
Chg.	-3.6%	-0.1%	3.9%	7.6%	10.5%
OP	2,750.0	3,521.6	3,841.0	4,173.0	4,933.3
Old estimates	3007.6	3975.8	4341.4	3898.7	3892.5
Chg.	-8.6%	-11.4%	-11.5%	7.0%	26.7%
OP Margin	12.2%	14.1%	14.2%	14.8%	16.8%
Old estimates	12.9%	15.9%	16.7%	14.9%	14.6%
Chg.	-0.7% pt	-1.8% pt	-2.5% pt	-0.1% pt	2.2% pt
NP	2,521.9	3,307.6	3,707.3	4,137.5	5,009.4
Old estimates	3,187.1	4,109.5	4,579.0	4,299.0	4,439.5
Chg.	-20.9%	-19.5%	-19.0%	-3.8%	12.8%

Source: Company data, Mirae Asset Research

Biggest beneficiary of the industry recovery

We are maintaining our Buy rating on the stock at target price of W330,000. We believe the company will be the biggest beneficiary of an imminent recovery of the cycle considering its most cost competitive position within the industry and its diversified product mix. We expect bulk carriers will drive new orders; moreover, the company has the most flexible production lines. From mid-2007 until 2008, the company demonstrated the strength of product mix by taking up to 30 bulk carriers.

Summary financial statements

Profit & Loss

(KRwb)	Dec-07A	Dec-08A	Dec-09E	Dec-10E	Dec-11E
Revenue	15,533	19,957	22,474	25,026	26,995
Cost of goods sold	(12,976)	(16,812)	(18,670)	(20,352)	(21,973)
Gross profit	2,557	3,145	3,804	4,674	5,022
SG and A	(806)	(939)	(1,054)	(1,153)	(1,181)
Op profit	1,751	2,206	2,750	3,522	3,841
Op EBITDA	2,143	2,597	3,203	4,026	4,343
Depreciation	(352)	(347)	(382)	(431)	(428)
Amortisation	(40)	(43)	(71)	(74)	(74)
Op EBIT	1,751	2,206	2,750	3,522	3,841
Net interest	188	273	382	414	550
Associates and JCEs	-	-	-	-	-
Other income	101	818	327	363	385
Net exceptional income	-	-	-	-	-
Profit before tax	2,040	3,297	3,459	4,299	4,776
Tax	(658)	(693)	(630)	(827)	(927)
Post-tax profit	1,381	2,604	2,829	3,472	3,849
Minorities	-	-	-	-	-
Preferred dividends	-	-	-	-	-
Net income	1,381	2,604	2,829	3,472	3,849
Norm profit	1,736	2,257	2,522	3,308	3,707
Dividends	(467)	(300)	(380)	(570)	(570)
Retained earnings	915	2,305	2,449	2,902	3,279

Source: Company data, Mirae Asset Research estimates

Cashflow

(KRwb)	Dec-07A	Dec-08A	Dec-09E	Dec-10E	Dec-11E
Op EBITDA	2,143	2,597	3,203	4,026	4,343
Decrease in working capital	2,595	491	(490)	(212)	1,305
Other operating cashflow	93	2,738	(1,025)	(1,029)	(34)
Operating cashflow	4,831	5,826	1,688	2,786	5,613
Tax paid	(658)	(693)	(630)	(827)	(927)
Net interest	188	273	382	414	550
Dividends received	(749)	(465)	(543)	(651)	(586)
Cashflow	3,612	4,942	898	1,722	4,651
Capital expenditure	(960)	(1,856)	(1,763)	(1,234)	(1,234)
Net acquisitions	-	-	-	-	-
Net investments	(263)	(2,626)	(175)	(184)	(193)
Other investing cashflow					
Investing cashflow	(1,222)	(4,482)	(1,938)	(1,418)	(1,427)
Dividends paid	(467)	(300)	(380)	(570)	(570)
Increase in equity	-	-	-	-	-
Increase in debt	2	(186)	500	(101)	(81)
Other financing cashflow	(0)	0	-	(0)	(0)
Financing cash flow	(465)	(485)	120	(671)	(651)
Beginning cash	1,276	3,611	2,446	2,328	1,911
Total cash generated	1,925	(25)	(920)	(366)	2,573
Forex effects					
Ending cash	3,200	3,586	1,526	1,962	4,484

Source: Company data, Mirae Asset Research estimates

Balance Sheet

(KRWb)	Dec-07A	Dec-08A	Dec-09E	Dec-10E	Dec-11E
Current assets	8,500	12,618	10,088	10,044	13,660
Cash and equivalents	3,611	2,446	2,328	1,911	5,544
Receivables	2,922	4,723	4,260	4,700	4,682
Inventories	1,119	2,263	1,815	1,979	1,979
Other current assets	848	3,185	1,685	1,455	1,455
Non current assets	8,325	12,663	14,708	16,567	17,313
Net operating fixed assets	4,969	6,190	7,478	8,458	8,373
Interest in associates	2,248	2,713	3,255	3,906	4,492
Other non-current assets	1,108	3,760	3,974	4,203	4,448
Total assets	16,824	25,280	24,796	26,611	30,973
Current liabilities	10,888	16,474	13,673	13,815	15,086
Payables	1,618	2,518	1,804	1,945	1,945
ST debt	187	-	101	81	64
Other current liabilities	9,083	13,956	11,769	11,789	13,076
Total non-current liabilities	445	3,211	2,625	1,561	1,514
LT debt	2	3	403	322	258
Other non-current liabilities	443	3,208	2,223	1,239	1,256
Total liabilities	11,333	19,685	16,298	15,376	16,600
Minorities	-	-	-	-	-
Issued capital	380	380	380	380	380
Share premium reserve	1,863	1,863	1,863	1,863	1,863
Reserves	909	956	956	956	956
Retained earnings	2,867	4,657	6,799	9,537	12,674
Other equity	-	-	-	-	-
Shareholders' equity	5,492	5,595	8,498	11,235	14,373

Source: Company data, Mirae Asset Research estimates

Key Ratios

	Dec-07A	Dec-08A	Dec-09E	Dec-10E	Dec-11E
Net revenue growth	23.7%	28.5%	12.6%	11.4%	7.9%
Gross profit growth	61.7%	23.0%	21.0%	22.9%	7.4%
Operating profit growth	99.2%	26.0%	24.6%	28.1%	9.1%
EBITDA growth	64.0%	52.2%	3.4%	24.3%	7.7%
EPS growth	143.5%	30.0%	11.8%	31.2%	12.1%
Norm BPS growth	35.4%	30.5%	27.3%	27.4%	24.6%
Gross margin	16.5%	15.8%	16.9%	18.7%	18.6%
Operating margin	11.3%	11.1%	12.2%	14.1%	14.2%
EBITDA margin	14.4%	17.1%	15.7%	17.5%	17.5%
EBIT margin	11.9%	15.2%	13.7%	15.5%	15.7%
Net income margin	8.9%	13.1%	12.6%	13.9%	14.3%
ROE	26.4%	37.5%	31.7%	30.5%	26.9%
ROA	9.3%	12.4%	11.3%	13.5%	13.4%
Net debt/equity	(62.3%)	(43.7%)	(21.5%)	(13.4%)	(36.3%)
Interest cover ratio	153.5	340.9	161.3	115.5	138.2
Dividend payout ratio	33.8%	11.5%	13.4%	16.4%	14.8%
Inventory days	31.48	49.27	35.49	35.49	32.87
Account receivable days	68.65	86.62	69.18	68.55	63.30
Account payable days	45.50	54.81	35.27	34.89	32.32
Reported EPS (KRW)	18,177	34,269	37,223	45,682	50,647
EPS (KRW)	22,843	29,693	33,183	43,522	48,780
Reported BPS (KRW)	79,190	103,365	131,548	167,570	208,850
Norm BPS (KRW)	79,190	103,365	131,548	167,570	208,850
DPS (KRW)	7,500	5,000	5,000	7,500	7,500
Cashflow per share (KRW)	47,521	65,023	11,813	22,659	61,194
Reported P/E (x)	12.02	6.38	5.87	4.78	4.31
Norm P/E (x)	9.57	7.36	6.58	5.02	4.48
P/B (x)	2.76	2.11	1.66	1.30	1.05
P/CF	4.60	3.36	18.50	9.64	3.57
EV/EBITDA (x)	5.88	4.15	4.19	3.44	2.41
EV/Operating Cashflow (x)	2.73	2.43	8.75	5.42	2.03
EV/Sales (x)	0.85	0.71	0.66	0.60	0.42
Dividend yield	3.43%	2.29%	2.29%	3.43%	3.43%

Source: Company data, Mirae Asset Research estimates

Recommendations

By stock (twelve months)

Buy: A target price + 10% or more above the current price,
 Hold: Target price within - 10% to +10% of the current price
 Reduce: A target price of -10% or less below the current price

By industry

Overweight: over +10% of the current industry index
 Neutral: -10% to +10% of the current industry index
 Underweight: -10% or less than the current industry index

Earnings quality score

Earnings Quality Score = 0.70*(Historical Earnings Stability) + 0.15*(Consensus Forecast Certainty) + 0.15*(Consensus Forecast Accuracy)

1. Historical Earnings Stability

- The variability of the net profit growth rate (YOY) over the last 20 quarters was translated into percentage terms.
- Earnings growth variability was calculated based on MAD (Median Absolute Deviation), rather than SD (Standard Deviation) in order to minimize distortion from outliers.
- The lower the earnings growth variability, the higher this indicator.

2. Consensus Forecast Certainty

- The gap between analysts' views on 12-month forward EPS was translated into percentage terms.
- The gap is calculated by dividing the SD of 12-month forward EPS with the average value.
- The narrower the gap is, the higher this indicator.

3. Consensus Forecast Accuracy

- The median value of absolute EPS surprise over the last 3-year was translated into percentage terms.
- EPS surprise was calculated based on 'the actual figure at the end of the year / the consensus estimate at the beginning of the year - 1'.
- The lower the absolute EPS surprise, the higher this indicator.

* Reference

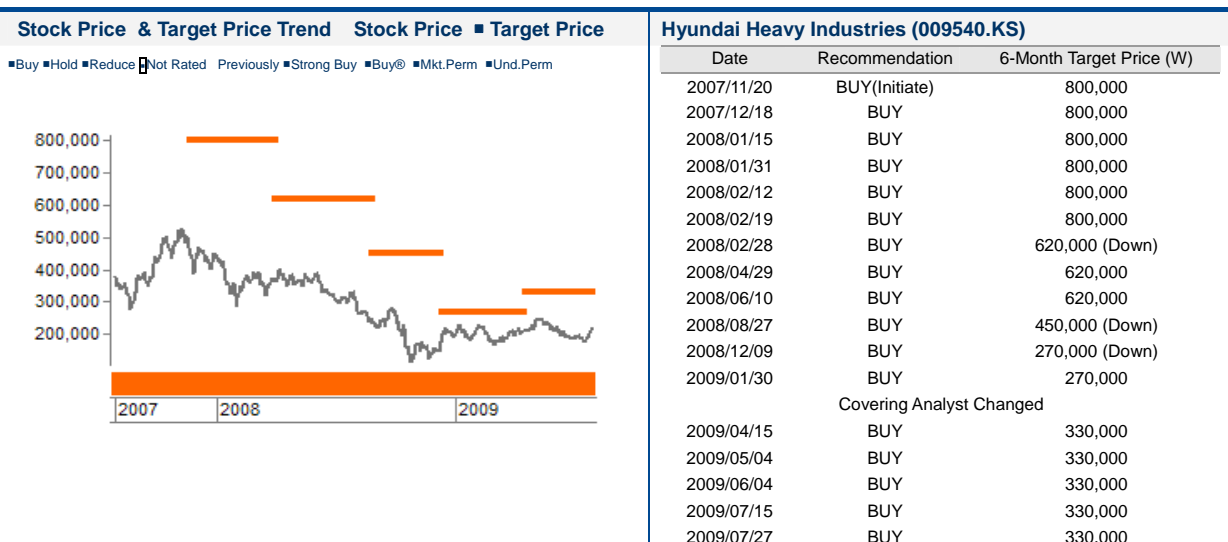
- 1) Consensus Forecast Certainty and Consensus Forecast Accuracy were applied only to companies with more than 5 years of EPS estimates.
- 2) We gave the average score of 50 to cases in which the aforementioned indicators could not be produced.

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[Analyst: Sokje Lee, Seohee Kim]

Stock	Analyst	Type	Securities Held by the Analyst		Purchase Date	Holdings of share of over 1%	Participation in Issuance of Securities	Involvement with Affiliates	Treasury Stock Held
			Number of Shares	Purchase Price					
			N/A						



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