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## WHAT'S NEW

## 3Q09 – confident strides

Hyundai Heavy reported 3Q09 figures, showing decent margin recovery QoQ from the fall of steel prices despite fewer working days. Operating margin has been restored to 10.7% again led by its offshore structure business unit. While sales growth has slowed, mainly from HHI's longer summer vacation in 3Q, the company still showed strong business stability. We believe the share has been overly discounted on overdone concerns over potential shipbuilding contract cancellations. Maintain Buy at target price W300,000.

- » Continued strong profitability
- » Performance by business unit – company comments
- » Highlighting its balanced business structure
- » Maintain Buy at target price W300,000

### Continued strong profitability

Hyundai Heavy reported W4,985bn sales in 3Q09, 6.5% down from 2Q09. Despite negative effects of seasonality (HHI had a longer summer vacation of 10 working days in 3Q09) and won appreciation (+9.3% QoQ), the company maintained strong revenues in its plant engineering unit (+23.4% QoQ) and construction equipment unit (+10.8% QoQ). The shipbuilding unit, a major concern in the market, saw sales decline by a relatively small 6.7% QoQ or -1.5% YoY due to increasing requests for delays in ship delivery. In contrast with market fears, we estimate that HHI is managing its ship deliveries properly.

The company's operating margin improved to 10.6% in 3Q09, up from 10.0% in 2Q09, and 7.1% in 3Q08. While it has suffered higher costs due to the rise in steel prices until 2Q09, Hyundai Heavy has started to show normalization in its margin trend. We expect further improvement in margin considering its order book status and normalized component prices going forward.

## IMPACT

#### Hedge fund investors

The share has receded on overdone concerns over potential order cancellation and further deterioration in the shipbuilding market. We believe these concerns will dissipate with time.

#### Long-only investors

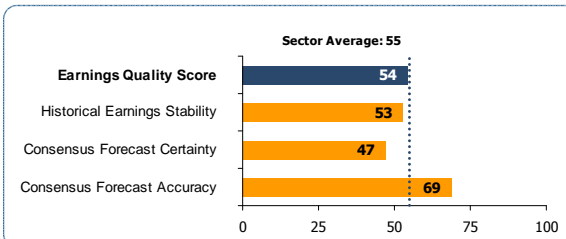
Trading now at 1.0x 10E book after its recent fall on similar negative sentiment as in Sept 08, we see this as an ideal time to enter the stock. The current market cap can be explained by our estimated profits for HHI for the next 3 years.

<b>Target price</b>	<b>₩300,000</b>
<b>Current price (29 October 2009)</b>	<b>₩164,000</b>
Upside/downside	82.9%
Consensus target price	₩248,000
Difference from consensus	21.0%

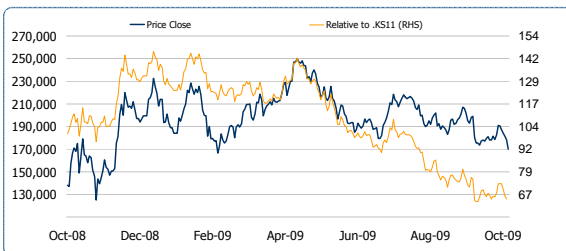
### Forecast earnings & valuation

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)	5.73	5.12	3.91	3.49
EV/EBITDA (x)	3.07	3.14	2.60	1.63
Dividend yield	2.94%	2.94%	4.41%	4.41%
P/B (x)	1.64	1.29	1.01	0.81
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	29,456	37,691	38,537
Prev EPS (KRW)	29,693	33,183	43,522	48,780

### Earnings quality score



### Performance



### Trading data

Market cap (₩bn/US\$m)	10,576/8,988		
Shares outstanding	76.00mn		
Free float	56%		
52-week price high/low	₩125,000 –250,000		
Daily average turnover (3M)	US\$67.90mn		
<b>Performance</b>	<b>1M</b>	<b>3M</b>	<b>12M</b>
Absolute	-14.2%	-19.8%	23.2%
Relative to KOSPI	-12.6%	-27.9%	-41.9%
Absolute (US\$)	-13.5%	-15.0%	52.4%
<b>Major shareholders</b>			
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

Figure 1. 3Q09 result summary

(Wbn)	3Q09P	3Q09 Con.	diff.,%, %p	2Q09	QoQ	3Q08	YoY
Sales	4,986	5,308	-6.1%	5,331	-6.5%	4,843	2.9%
OP	532	544	-2.3%	535	-0.6%	344	54.6%
OP margin	10.7	10.3	0.5%p	10.0	0.7%p	7.1	3.6%p
Pre-Tax Profit	699	639	9.3%	471	48.4%	406	72.4%
NP	534	475	12.5%	393	35.9%	292	83.0%

Source: Company data, Mirae Asset Research

### Performances by business unit – company comments

**Shipbuilding & Engines:** QoQ decline from won appreciation and change of manufacturing process especially in engines. Margins improved through fall in steel price and component costs.

**Offshore & plant:** Decrease of shipbuilding on land, but significant improvement in overseas plant unit. Margins improved mainly through sales growth in the overseas market.

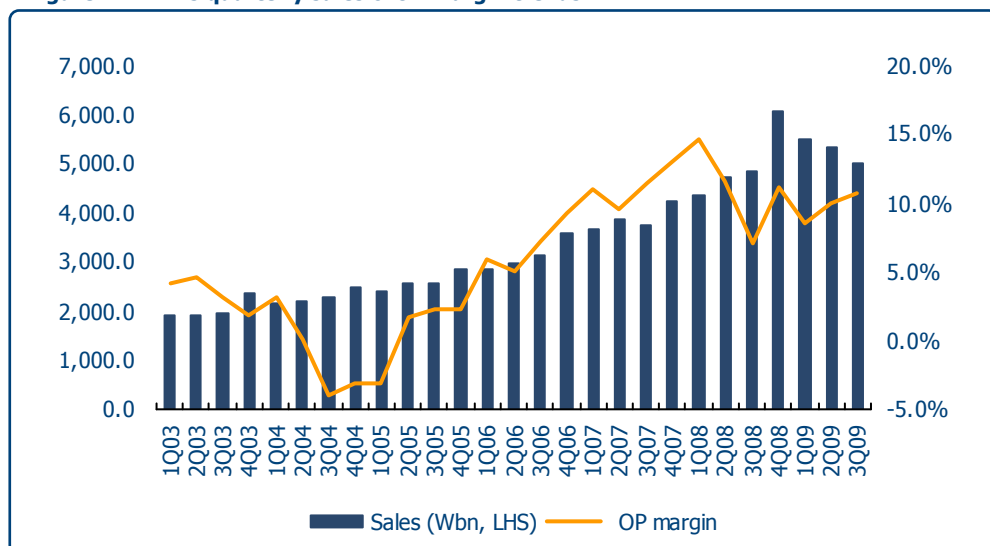
**Electro electric:** Temporary slowdown of sales due to global economic slowdown and won appreciation. Some margin deterioration QoQ comes mainly from won appreciation.

**Construction equipment:** Strong recovery in China and the Middle East. Strong sales growth in China partially offset by slowdown of sales in developed countries.

### Highlighting the balanced business structures

Again, the company proved its stability of business again. Despite high volatility of shipbuilding industry, in terms of order flows and margin trends, the company maintained strong consistency in sales and operating margin. Firstly, the company has vertically integrated business structures, and thus shows relatively stable margin trends than peers. Secondly, the company has strong non-shipbuilding unit, especially its plant engineering, offshore plant, electro electric unit, and construction equipment unit. Most these business units share the same driver, commodity cycle, and economic growth of developing countries, but new orders are not overlapping others. While its new orders YTD slowed down by 72%, the volatility is much less than its peers.

Figure 2. HHI's quarterly sales & OP margin trends



Source: Company data, Mirae Asset Research

### Maintain Buy at target price W300,000

For the past several weeks, Hyundai Heavy's share price has shown weakness amid concerns over potential cancellation of shipbuilding contracts. But we believe most such concerns are highly exaggerated and extreme assumptions are in the price. Shipbuilding contracts, once signed, cannot be modified or cancelled that easily by ship owners. To cancel contracts, ship owners need the agreement of shipyards, without which they would have to bear huge penalty costs. HHI is trading at less than 1x 2010E book despite our estimated 30.5% ROE in 2010. We believe that solid earnings and recovery in shipbuilding contracts going forward will mitigate such market concerns. Maintain Buy on the stock at W300,000 target price.

The share reflects concerns on potential shipbuilding contract cancellations which we believe are unlikely to happen

## Summary financial statements

### Profit & Loss

(KRwb)	Dec-07A	Dec-08A	Dec-09E	Dec-10E	Dec-11E
<b>Revenue</b>	<b>15,533</b>	<b>19,957</b>	<b>22,474</b>	<b>25,026</b>	<b>26,995</b>
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)
<b>Op profit</b>	<b>1,751</b>	<b>2,206</b>	<b>2,750</b>	<b>3,522</b>	<b>3,841</b>
<b>Op EBITDA</b>	<b>2,143</b>	<b>2,597</b>	<b>3,203</b>	<b>4,026</b>	<b>4,343</b>
Depreciation	(352)	(347)	(382)	(431)	(428)
Amortisation	(40)	(43)	(71)	(74)	(74)
<b>Op EBIT</b>	<b>1,751</b>	<b>2,206</b>	<b>2,750</b>	<b>3,522</b>	<b>3,841</b>
Net interest	188	273	382	414	550
Associates and JCEs	-	-	-	-	-
Other income	101	818	327	363	385
Net exceptional income	-	-	-	-	-
<b>Profit before tax</b>	<b>2,040</b>	<b>3,297</b>	<b>3,459</b>	<b>4,299</b>	<b>4,776</b>
Tax	(658)	(693)	(630)	(827)	(927)
<b>Post-tax profit</b>	<b>1,381</b>	<b>2,604</b>	<b>2,829</b>	<b>3,472</b>	<b>3,849</b>
Minorities	-	-	-	-	-
Preferred dividends	-	-	-	-	-
<b>Net income</b>	<b>1,381</b>	<b>2,604</b>	<b>2,829</b>	<b>3,472</b>	<b>3,849</b>
Norm profit	1,736	2,257	2,522	3,308	3,707
Dividends	(467)	(300)	(380)	(570)	(570)
<b>Retained earnings</b>	<b>915</b>	<b>2,305</b>	<b>2,449</b>	<b>2,902</b>	<b>3,279</b>

Source: Company data, Mirae Asset Research estimates

### Cashflow

(KRwb)	Dec-07A	Dec-08A	Dec-09E	Dec-10E	Dec-11E
<b>Op EBITDA</b>	<b>2,143</b>	<b>2,597</b>	<b>3,203</b>	<b>4,026</b>	<b>4,343</b>
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)
<b>Cashflow</b>	<b>3,612</b>	<b>4,942</b>	<b>898</b>	<b>1,722</b>	<b>4,651</b>
Capital expenditure	(960)	(1,856)	(1,763)	(1,234)	(1,234)
Net acquisitions	-	-	-	-	-
Net investments	(263)	(2,626)	(175)	(184)	(193)
Other investing cashflow	-	-	-	-	-
<b>Investing cashflow</b>	<b>(1,222)</b>	<b>(4,482)</b>	<b>(1,938)</b>	<b>(1,418)</b>	<b>(1,427)</b>
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)
<b>Financing cash flow</b>	<b>(465)</b>	<b>(485)</b>	<b>120</b>	<b>(671)</b>	<b>(651)</b>
Beginning cash	1,276	3,611	2,446	2,328	1,911
<b>Total cash generated</b>	<b>1,925</b>	<b>(25)</b>	<b>(920)</b>	<b>(366)</b>	<b>2,573</b>
Forex effects	-	-	-	-	-
<b>Ending cash</b>	<b>3,200</b>	<b>3,586</b>	<b>1,526</b>	<b>1,962</b>	<b>4,484</b>

Source: Company data, Mirae Asset Research estimates

### Balance Sheet

(KRWb)	Dec-07A	Dec-08A	Dec-09E	Dec-10E	Dec-11E
<b>Current assets</b>	<b>8,500</b>	<b>12,618</b>	<b>10,088</b>	<b>10,044</b>	<b>13,660</b>
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
<b>Non current assets</b>	<b>8,325</b>	<b>12,663</b>	<b>14,708</b>	<b>16,567</b>	<b>17,313</b>
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
<b>Total assets</b>	<b>16,824</b>	<b>25,280</b>	<b>24,796</b>	<b>26,611</b>	<b>30,973</b>
<b>Current liabilities</b>	<b>10,888</b>	<b>16,474</b>	<b>13,673</b>	<b>13,815</b>	<b>15,086</b>
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
<b>Total non-current liabilities</b>	<b>445</b>	<b>3,211</b>	<b>2,625</b>	<b>1,561</b>	<b>1,514</b>
LT debt	2	3	403	322	258
Other non-current liabilities	443	3,208	2,223	1,239	1,256
<b>Total liabilities</b>	<b>11,333</b>	<b>19,685</b>	<b>16,298</b>	<b>15,376</b>	<b>16,600</b>
Issued capital	380	380	380	380	380
Share premium reserve	1,863	1,863	1,863	1,863	1,863
Reserves/Adjustments	909	956	956	956	956
Retained earnings	2,867	4,657	6,799	9,537	12,674
Minorities	-	-	-	-	-
Other equity	(527)	(2,260)	(1,500)	(1,500)	(1,500)
<b>Shareholders' equity</b>	<b>5,492</b>	<b>5,595</b>	<b>8,498</b>	<b>11,235</b>	<b>14,373</b>

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)	9.35	4.96	4.57	3.72	3.36
Norm P/E (x)	7.44	5.73	5.12	3.91	3.49
P/B (x)	2.15	1.64	1.29	1.01	0.81
P/CF	3.58	2.61	14.39	7.50	2.78
EV/EBITDA (x)	4.23	3.07	3.14	2.60	1.63
EV/Operating Cashflow (x)	1.97	1.80	6.57	4.10	1.37
EV/Sales (x)	0.61	0.52	0.49	0.46	0.29
Dividend yield	4.41%	2.94%	2.94%	4.41%	4.41%

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			Holdings of share of over 1%	Participation in Issuance of Securities	Involvement with Affiliates	Treasury Stock Held
			Number of Shares	Purchase Price	Purchase Date				

N/A

Stock Price & Target Price Trend	Stock Price	Target Price	Hyundai Heavy Industries (009540.KS)		
			Date	Recommendation	6-Month Target Price (W)
			2007/11/20	BUY(Initiate)	800,000
			2007/12/18	BUY	800,000
			2008/01/15	BUY	800,000
			2008/01/31	BUY	800,000
			2008/02/12	BUY	800,000
			2008/02/19	BUY	800,000
			2008/02/28	BUY	620,000 (Down)
			2008/04/29	BUY	620,000
			2008/06/10	BUY	620,000
			2008/08/27	BUY	450,000 (Down)
			2008/12/09	BUY	270,000 (Down)
			2009/01/30	BUY	270,000
			Covering Analyst Changed		
			2009/04/15	BUY	330,000
			2009/05/04	BUY	330,000
			2009/06/04	BUY	330,000
			2009/07/15	BUY	330,000
			2009/07/27	BUY	330,000
			2009/07/30	BUY	300,000(Down)
			2009/10/30	BUY	300,000

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