

# Hyundai Heavy Industries (009540)

*Survivability deserves premium*

Reiterate:

**BUY(M)**

	BELOW	IN LINE	ABOVE
Industry		Shipbuilding	
Close (Apr 30)		KRW230,000	
6-month TP		KRW260,000	
KOSPI		1,369	
KOSDAQ		501	
Exchange rate		KRW1,290/USD	
Shares outstanding		76,000,000	
Market cap		KRW17.5t/USD13.6b	
52-week high/low		KRW396,000/ KRW103,000	
Share ownership		MJ Chung (10.8%)	

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## 1Q sales and operating profit in line with forecasts

Hyundai Heavy Industries (HHI) today reported 1Q results in line with our forecasts, with sales of KRW5.5b and an operating profit of KRW471b (for a margin of 8.6%).

### Positives:

- ▶ We expect HHI's shipbuilding and offshore-structure sales to rise 10% to a peak of around KRW13t in 2009.
- ▶ The electronic-systems division posted a solid 1Q operating margin of 21.5% (reflecting common expenses) on increasing overseas demand for electrical equipment and a weak won.

### Negatives:

- ▶ HHI's shipbuilding operating margin missed our estimate of 5%, while equity-method gains came in at a lower-than-expected KRW87.3b (vs KRW258.8b in 4Q08).
- ▶ Major domestic shipbuilders have an order backlog of around 455 containerships, of which we estimate 168 (or 36.9%) are scheduled to be delivered over 2011- 2012 and are at risk of delivery delays or cancellations—with half of this (84 vessels) in HHI and Hyundai Samho Heavy's backlog. Even assuming no substantial cancellations, we see a high likelihood that delivery delays will require us to slash our 2010 sales estimates for the shipbuilding and offshore divisions (table 1).
- ▶ We expect the firm's 2009 shipbuilding orders to reach just USD1b, far short of its guidance of USD7.5b. The company has yet to receive an order this year.

## Survivability justifies sector-high target multiple

We revise down our 2009 EPS estimate by 6.4%, reflecting the lower-than-expected profitability in HHI's shipbuilding division and equity-method gains in 1Q. However, we revise up our six-month target price from KRW240,000 to KRW260,000, based on 2.5x 2009 P/B—granting the company the highest target multiple we give to Korea's big three shipbuilders. We believe HHI deserves a premium because its wider business spectrum provides it with a greater chance of surviving amid a dearth of new shipbuilding orders, and despite an expected slowdown in top-line growth after 2010.

## Summary of 1Q results

(KR)	1Q09	Chg		Diff (%)	
		(% y-y)	(% q-q)	Samsung	Consensus
Sales	5,494	26.2	(9.2)	(1.2)	3.4
Operating profit	471	(26.3)	(30.2)	(9.5)	(4.5)
Pre-tax profit	633	(2.7)	(36.1)	(14.8)	(11.2)
Net profit	498	12.7	(42.5)	(6.9)	(4.9)
<b>Margins (%)</b>					
Operating profit	8.6				
Pre-tax profit	11.5				
Net profit	9.1				

## Valuation summary

	2008A	2009E	2010E
<b>Multiples (x)</b>			
P/E	7.8	7.9	6.2
P/B	3.1	2.2	1.8
EV/EBITDA	5.9	5.2	4.1
Dividend yield (%)	2.2	1.5	1.5
EPS growth (%)	28.0	(1.1)	27.7
ROE (%)	40.3	32.2	31.5
<b>Per share data (KRW)</b>			
EPS	29,409	29,080	37,147
BVPS	73,621	106,785	129,220
DPS	5,000	3,500	3,500

Source: Company data, FnGuide, Samsung Securities estimates

- During the three months prior to Apr 30, 2009, Samsung Securities had not participated in any securities issuance (including DRs, CBs, and IPOs) by companies covered in this report.
- As of Apr 30, 2009, Samsung Securities' holdings of shares and debt instruments convertible into shares of each company covered in this report would not, if such debt instruments were converted, exceed 1% of each company's outstanding shares.
- As of Apr 30, 2009, the covering analyst(s) did not own any shares, or debt instruments convertible into shares, of any company covered in this report.
- This report has been prepared without any undue external influence or interference, and accurately reflects the views of the analyst(s) covering the company or companies herein.

## Results Note

**Table 1. Major domestic shipbuilders' containership delivery schedules**

(Vessels)	2009	2010	2011	2012	Total	Ship owners
<b>Under 3,000 TEU</b>						
HHI	3	1	0	0	4	Delphis NV (4)
HMD	5	10	0	0	15	Cido Shipping (3), Hartmann Schiff (2), unknown (10)
STX Shipbuilding	5	0	0	0	5	Nippon Yusen Kaisha (5)
<b>3,000-5,999 TEU</b>						
SHI	10	10	3	0	23	Danaos Shipping (1), Hanjin Shipping (1), Itochu (2), Orient Overseas International (9), Seaspan Container (5), Synergy Marine (1), Thomas Schulte (4)
HHI	15	5	17	8	45	A.P. Moller (17), Jungerhans & Co (2), Kawasaki Kisen (9), MPC Group (5), Reederei Claus-Peter Offen (8), Seaspan Container (4)
Hyundai Samho	7	7	8	7	29	A.P. Moller (5), Dioryx Maritime (4), MPC Group (6), Nippon Yusen Kaisha (4), Schulte Group (10)
DSME	9	11	0	0	20	Conti Reederei (1), Marlow Navigation (2), NVA Norddeutsche (5), Schulte Group (2), Seacastle Singapore (4), Thien & Heyenga (3), Tom Worden Schiffs (3)
HHIC (Busan)	5	8	4	0	17	A.P. Moller (4), Danaos Shipping (5), Delphis NV (4), unknown (4)
HHIC (Subic)	8	8	2	0	18	Allocean (2), Dioryx Maritime (2), NSC Schifffahrt (4), CMA-CGM (10)
<b>6,000-9,999 TEU</b>						
SHI	4	6	0	0	10	CMA-CGM (6), Orient Overseas International (4)
HHI	13	24	5	1	43	Hapag-Lloyd AG (14), D. Oltmann (3), Rickmers Reederei (8), Schulte Group (3), Seaspan Container (8), Synergy Marine (6), Zodiac Maritime Agency (1)
Hyundai Samho	6	5	0	0	11	Hanjin Shipping (5), Zim Integrated Shipping (4), CSAV (2)
DSME	3	10	8	7	28	A.P. Moller (16), NVA Norddeutsche (8), Reederei Claus-Peter Offen (4)
HHIC (Busan)	8	4	0	0	12	Builders Account (3), CMA-CGM (4), Danaos Shipping (5)
<b>Over 10,000 TEU</b>						
SHI	6	12	24	12	54	China Shipping Group (8), CSAV (3), Hanjin Shipping (5), Mediterranean Shipping (6), Peter Dohle Schiff (9), Reederei Claus-Peter Offen (5), United Arab Shipping (9), Zim Integrated Shipping (9)
HHI	7	16	19	4	46	CMA-CGM (11), MPC Group (9), Neptune Orient Lines (4), Nordcapital (8), Rickmers Reederei (8), Seaspan Container (5), Zodiac Maritime Agency (1)
Hyundai Samho	4	4	15	0	23	Danaos Shipping (8), Seaspan Container (3), Zim Integrated Shipping (7), Zodiac Maritime Agency (5)
DSME	6	14	15	0	35	CMA-CGM (8), Conti Reederei (1), Mediterranean Shipping (4), Neptune Orient Lines (4), Reederei Claus-Peter Offen (18)
HHIC (Subic)	0	4	4	0	8	NSC Schifffahrt (8)
STX Shipbuilding	0	4	5	0	9	Niki Group (9)

Note: Based on current order backlogs

Source: Clarkson, Samsung Securities

## Results Note

### Income statement

Year-end Dec 31 (KRWb)	2006	2007	2008	2009E	2010E
<b>Sales</b>	<b>12,555</b>	<b>15,533</b>	<b>19,957</b>	<b>22,477</b>	<b>24,122</b>
Manufactured goods	12,555	15,533	19,957	22,477	24,122
Merchandise and other	0	0	0	0	0
Cost of goods sold	10,973	12,976	16,812	18,984	19,760
Manufactured	10,973	12,976	16,812	18,984	19,760
Merchandise and other	0	0	0	0	0
<b>Gross profit</b>	<b>1,581</b>	<b>2,557</b>	<b>3,145</b>	<b>3,493</b>	<b>4,362</b>
SG&A expenses	702	806	939	1,091	1,131
Labor	304	351	367	399	423
Depreciation	25	26	32	34	36
Other	373	429	539	658	672
<b>Operating profit</b>	<b>879</b>	<b>1,751</b>	<b>2,206</b>	<b>2,402</b>	<b>3,231</b>
Non-operating income	597	955	3,827	1,064	1,067
Interest income	96	205	289	219	202
Forex gains	111	101	818	105	70
Other	390	649	2,720	739	795
Non-operating expenses	444	311	3,084	436	406
Interest expenses	11	11	6	47	44
Forex losses	187	86	762	135	95
Other	247	213	2,315	255	267
<b>Pre-tax profit</b>	<b>1,031</b>	<b>2,394</b>	<b>2,950</b>	<b>3,030</b>	<b>3,891</b>
Taxes	318	658	693	848	1,089
<b>Net profit</b>	<b>713</b>	<b>1,736</b>	<b>2,257</b>	<b>2,181</b>	<b>2,802</b>
EBITDA	1,227	2,102	2,554	3,237	4,136
EPS (KRW)*	10,586	22,968	29,409	29,080	37,147

### Cash flow

Year-end Dec 31 (KRWb)	2006	2007	2008	2009E	2010E
<b>Operating cash flow</b>	<b>1,639</b>	<b>4,116</b>	<b>2,383</b>	<b>(330)</b>	<b>1,073</b>
Net profit	713	1,736	2,257	2,181	2,802
Depreciation	389	366	385	415	435
Severance payments	116	56	61	98	99
Forex losses (gains)	10	(5)	(21)	40	30
Associated losses (gains)	(179)	(483)	(620)	(483)	(570)
Chg in working capital	380	2,391	(251)	(2,582)	(1,724)
Other	210	54	572	0	0
<b>Investment cash flow</b>	<b>(1,168)</b>	<b>(3,476)</b>	<b>(1,184)</b>	<b>(532)</b>	<b>(652)</b>
Capex	(594)	(1,003)	(1,889)	(1,242)	(827)
Free cash flow	549	1,455	(1,573)	694	2,452
Chg in investment assets	(333)	(364)	(276)	25	25
Other	(241)	(2,109)	981	685	150
<b>Financing cash flow</b>	<b>(96)</b>	<b>(506)</b>	<b>(1,485)</b>	<b>730</b>	<b>(366)</b>
Chg in short-term debt	0	0	0	0	0
Chg in long-term debt	1	0	2	300	0
Chg in bonds	(16)	(185)	0	600	(100)
Chg in current maturities	(0)	187	(187)	130	0
Dividends	(97)	(161)	(467)	(300)	(266)
Rights issues	0	0	0	0	0
Other	16	(347)	(833)	0	0
Adjustments	0	0	0	0	0
<b>Chg in cash</b>	<b>375</b>	<b>134</b>	<b>(286)</b>	<b>(132)</b>	<b>54</b>
Cash at beg of year	445	820	954	667	536
Cash at end of year	820	954	667	536	590

Note: \* Fully diluted

Source: Company data, Samsung Securities estimates

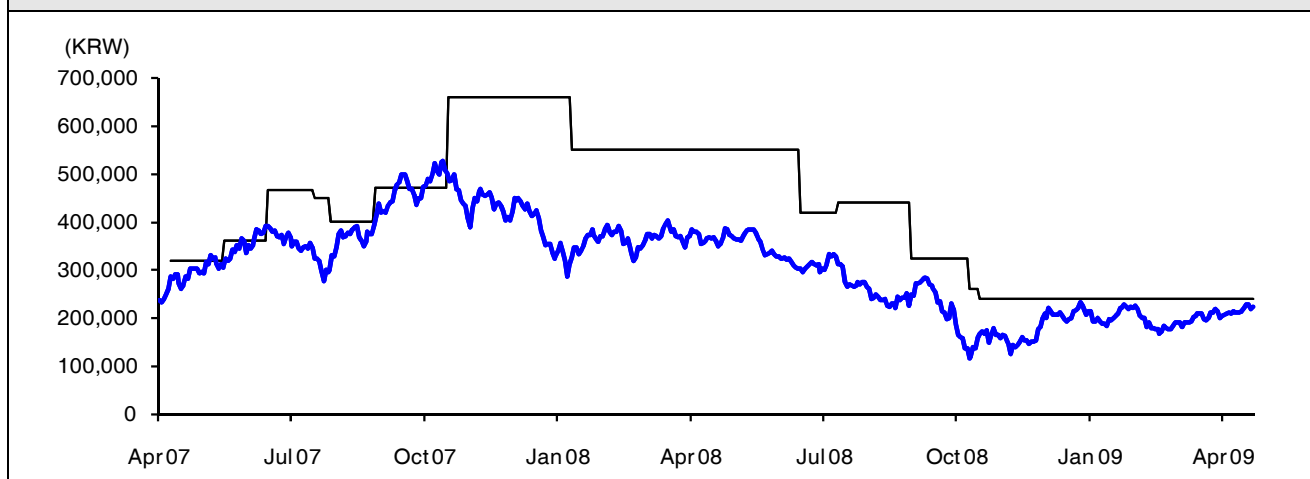
### Balance sheet

Year-end Dec 31 (KRWb)	2006	2007	2008	2009E	2010E
<b>Current assets</b>	<b>6,211</b>	<b>8,500</b>	<b>12,618</b>	<b>12,261</b>	<b>11,235</b>
Cash & equivalents	820	954	667	536	590
Financial goods	234	2,154	1,676	1,055	959
Marketable securities	222	503	102	100	100
Accounts receivable	2,445	2,741	4,499	4,927	5,155
Inventories	1,129	1,119	2,263	2,648	2,049
Other current assets	1,362	1,028	3,409	2,996	2,383
<b>Non-current assets</b>	<b>6,785</b>	<b>8,325</b>	<b>12,663</b>	<b>12,812</b>	<b>12,057</b>
Investment assets	1,935	2,972	3,224	3,223	3,222
Tangible assets	4,455	4,969	6,190	6,969	7,310
Intangible assets	222	236	262	242	242
Other	173	148	2,986	2,378	1,283
<b>Total assets</b>	<b>12,996</b>	<b>16,824</b>	<b>25,280</b>	<b>25,073</b>	<b>23,292</b>
<b>Current liabilities</b>	<b>8,153</b>	<b>10,888</b>	<b>16,474</b>	<b>13,477</b>	<b>10,858</b>
Accounts payable	1,180	1,495	2,337	2,525	2,445
Short-term borrowings	0	0	0	0	0
Current portion of LT debt	0	187	0	130	130
Other current liabilities	6,973	9,205	14,137	10,822	8,283
<b>Non-current liabilities</b>	<b>522</b>	<b>445</b>	<b>3,211</b>	<b>3,481</b>	<b>2,613</b>
Bonds	185	0	0	600	500
Long-term debt	1	2	3	303	303
Other long-term liabilities	335	443	3,208	2,577	1,810
<b>Total liabilities</b>	<b>8,675</b>	<b>11,333</b>	<b>19,685</b>	<b>16,958</b>	<b>13,471</b>
Capital stock	380	380	380	380	380
Capital surplus	2,771	2,771	2,819	2,866	2,913
Retained earnings	1,292	2,867	4,657	6,539	9,074
Capital adjustments	(352)	(697)	(1,762)	(1,274)	(1,918)
Other comprehensive income	229	170	(498)	(394)	(628)
<b>Total equity</b>	<b>4,321</b>	<b>5,492</b>	<b>5,595</b>	<b>8,116</b>	<b>9,821</b>

### Financial ratios

Year-end Dec 31	2006	2007	2008	2009E	2010E
<b>Growth (% y-y)</b>					
Sales	21.3	23.7	28.5	12.6	7.3
Operating profit	867.4	99.2	26.0	8.9	34.5
Pre-tax profit	300.0	132.2	23.2	2.7	28.4
Net profit	288.9	143.5	30.0	(3.3)	28.4
EBITDA	188.0	71.4	21.5	26.7	27.8
EPS*	443.1	117.0	28.0	(1.1)	27.7
<b>Margins (%)</b>					
Operating profit	7.0	11.3	11.1	10.7	13.4
Pre-tax profit	8.2	15.4	14.8	13.5	16.1
Net profit	5.7	11.2	11.3	9.7	11.6
EBITDA	9.8	13.5	12.8	14.4	17.1
ROE	20.2	35.6	40.3	32.2	31.5
ROA	5.8	11.6	10.7	8.7	11.6
<b>Ratios</b>					
Net debt/equity (%)	nc	nc	nc	nc	nc
Liabilities/equity (%)	200.8	206.4	351.8	209.0	137.2
Interest coverage (x)	nm	nm	nm	nm	nm
Receivables turnover (x)	5.3	6.0	5.5	4.8	4.8
<b>Per share data (KRW)</b>					
Sales	165,194	204,382	262,593	295,756	317,392
Book value	56,853	72,257	73,621	106,785	129,220
Dividend	2,500	7,500	5,000	3,500	3,500
Payout (%)	22.6	26.9	13.3	12.2	9.5
EBITDA	16,141	27,663	33,599	42,586	54,424

### Target price changes in past two years



### Rating changes in past two years

Date	2007. 5/7	5/8	6/13	7/11	8/10	8/22	9/19	11/8	2008. 2/1	7/7
Recommendation	BUY(M)	BUY(M)	BUY(M)	BUY(M)	BUY(M)	BUY(M)	BUY(M)	BUY(M)	BUY(M)	BUY(M)
Target price (KRW)	250,000	320,000	362,000	466,000	450,000	400,000	470,000	660,000	551,000	420,000
Date	7/30	9/16	10/24	10/31	2009. 4/30					
Recommendation	BUY(M)	BUY(M)	BUY(M)	BUY(M)	BUY(M)					
Target price (KRW)	440,000	325,000	260,000	240,000	260,000					

- Stock Ratings:** Our stock rating system consists of two tiers—investment ratings (BUY, HOLD, and SELL recommendations based on absolute returns of shares over the next 6 months) and risk ratings (High, Medium, or Low).

**BUY** : An expected return of +10% or greater for a low-risk stock, +15% or greater for medium risk, and +20% or greater for high risk

**HOLD** : An expected return between -10% and +10% for a low-risk stock, -15% and +15% for medium risk, and -20% and +20% for high risk

**SELL** : An expected return of -10% or worse for a low-risk stock, -15% or worse for medium risk, and -20% or worse for high risk

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