

POSCO
005490 KS

Target (KRW): **320,000 → 320,000**

Upside: **2.4%**

15 Oct price (KRW): **312,500**

- 1 Buy
- 2 Outperform
- 3 Hold (unchanged)
- 4 Underperform
- 5 Sell

Still lacking upside momentum

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- 2H13 earnings tracking weaker than we expected
- Still difficult to raise prices, despite possible demand recovery
- Risk-reward profile does not look particularly appealing

■ What's new

We believe that the company's 2H13 earnings are tracking weaker than we expected previously.

■ What's the impact

We are cutting our 2013E EPS by 17% to factor in a cut to our 2H13 earnings forecast. However, we are raising our 2014 EPS forecast by 5% as we now expect higher shipments and lower iron-ore prices than we forecast previously.

POSCO is due to announce its 3Q13 results on 24 October. Factoring in: 1) a drop of KRW20,000/tonne QoQ in the per-tonne carbon steel ASP to KRW789,000 in 3Q13, compared with our previous forecast of a 3% QoQ rise to KRW833,000, 2) a 3% cut to our 3Q13 shipment forecast to 8.3m tonnes, and 3) weak non-steel business earnings for its trading, energy, and ICT business, we are cutting our 3Q13 revenue and operating-profit forecasts by 4% to KRW15.1tn (from KRW15.7tn) and 8% to KRW695bn (from KRW755bn), respectively. These are

below the respective Bloomberg-consensus forecasts by 3% and 5%.

We now forecast POSCO's 4Q13 operating-profit to rise by 28% QoQ to KRW891bn (KRW920bn previously), mainly due to: 1) a sharp decline in the combined input cost for iron-ore and coking coal of KRW20,000/tonne QoQ to KRW379,000/tonne, and 2) an improvement in earnings for its construction business. We are cutting our forecast as we do not expect the company to raise domestic HRC prices by a large amount from the current KRW730,000/tonne.

According to *Korea Metal Journal*, the price gap between domestic HRC and imported HRC products has widened to KRW50,000-KRW60,000/tonne over the past month, which does not bode well for POSCO's attempts to raise prices. We expect a continued downward trend in China HRC prices. Thus, while we forecast a 3% YoY increase in POSCO's 2014 steel demand to 35m tonnes (with a moderate recovery in its downstream industries), we do not expect a major upswing in the company's earnings-revision cycle for 2014.

■ What we recommend

We maintain our Hold (3) rating and Gordon Growth Model-based six-month target price of KRW320,000. We believe POSCO's share price will see some support given its 10.5% YTD decline, with a possible QoQ rebound in 4Q13 earnings, and with the stock trading currently at a 2013E PBR of 0.6x with a 2013E ROE of 5.3%. However, we see limited upside potential as: 1) we expect the weak pricing environment to persist for HRC given an oversupply, and 2)

continued market-share losses to Hyundai Steel (004020 KS, KRW87,000, Outperform [2]) and Hyundai Hysco (010520 KS, KRW40,100, Hold [3]) in Korea. Upside catalysts to our call include a significant rebound in global steel prices. A main downside risk is weaker-than-expected demand from downstream industries.

■ How we differ

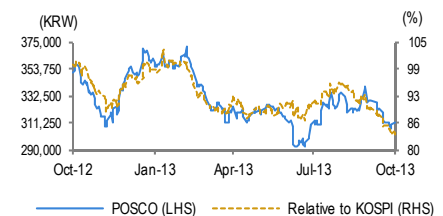
Our 2013-14E EPS are 5-7% higher than those of the consensus, as we are more bullish on POSCO's shipments.

Forecast revisions (%)

Year to 31 Dec	13E	14E	15E
Revenue change	(0.9)	1.7	1.8
Net profit change	(17.1)	5.1	1.9
Core EPS (FD) change	(17.1)	5.1	1.9

Source: Daiwa forecasts

Share price performance



12-month range	292,500-371,000
Market cap (USDbn)	25.54
3m avg daily turnover (USDm)	72.31
Shares outstanding (m)	87
Major shareholder	National Pension Service (5.4%)

Financial summary (KRW)

Year to 31 Dec	13E	14E	15E
Revenue (bn)	61,933	64,248	66,458
Operating profit (bn)	3,206	3,793	4,150
Net profit (bn)	2,255	3,092	3,307
Core EPS (fully-diluted)	25,862	35,462	37,932
EPS change (%)	(5.5)	37.1	7.0
Daiwa vs Cons. EPS (%)	5.4	7.0	5.8
PER (x)	12.1	8.8	8.2
Dividend yield (%)	2.6	2.6	2.6
DPS	8,000	8,000	8,000
PBR (x)	0.6	0.6	0.6
EV/EBITDA (x)	6.8	6.2	5.9
ROE (%)	5.3	7.0	7.1

Source: FactSet, Daiwa forecasts

■ **Global steel companies: valuation summary**

BBG code	Share price	Daiwa rating	Mkt cap (USDm)	Absolute (%)			**Relative (%)			PER (x)				EV/EBITDA (x)				Div. yield (%)							
				YTD	1M	3M	YTD	1M	3M	13E	14E	13E	14E	13E	14E	13E	14E	13E	14E						
Korea																									
POSCO*	005490 KS	KRW	312,500	Hold	25,509	(10.5)	(4.4)	(0.3)	(12.6)	(6.7)	(9.1)	12.1	8.8	0.6	0.6	6.8	6.2	4.4	5.2	5.3	7.0	2.6	2.6	5.2	5.9
Hyundai Steel*	004020 KS	KRW	87,000	Outperform	7,005	(0.9)	9.0	28.3	(3.0)	6.8	19.6	11.7	9.0	0.7	0.7	11.9	8.6	1.2	1.4	6.3	7.8	0.7	0.8	6.0	8.0
Hyundai Hysco*	010520 KS	KRW	40,100	Hold	3,127	(11.8)	(12.6)	5.8	(13.9)	(14.9)	(2.9)	10.8	8.9	1.5	1.3	5.0	4.4	0.5	0.6	15.0	15.7	0.7	0.7	5.2	5.3
Dongkuk Steel Mill	001230 KS	KRW	15,650	Not rated	912	14.2	7.6	25.2	12.1	5.3	16.5	(7.9)	(14.0)	0.4	0.4	14.0	13.4	3.6	4.5	(4.7)	(2.4)	3.2	3.1	0.9	1.4
Japan																									
Nippon Steel	5401 JP	JPY	343	Outperform	32,788	63.3	3.9	14.7	24.2	3.0	15.2	13.5	11.9	1.2	1.2	9.4	8.5	5.7	5.6	9.1	9.7	1.4	1.7	5.6	7.0
JFE Holdings	5411 JP	JPY	2,507	Hold	15,694	56.5	(3.4)	1.0	17.4	(4.3)	1.5	10.8	8.7	0.9	0.8	7.7	6.8	4.9	4.2	8.2	9.1	2.0	2.3	5.7	7.0
Kobe Steel	5406 JP	JPY	177	Hold	5,564	62.4	1.7	23.8	23.3	0.8	24.3	9.4	11.5	0.9	0.9	8.3	7.8	4.0	4.2	10.3	7.6	1.0	1.3	5.0	5.4
China																									
Baoshan Iron & Steel	600019 CH	CHY	4.2	Not rated	11,422	(13.7)	(5.8)	3.7	(11.1)	(4.6)	(3.7)	10.0	8.8	0.6	0.6	6.7	6.0	4.9	3.9	6.1	7.1	3.8	4.4	4.9	5.7
Angang Steel	347 HK	CHY	4.7	Buy	3,740	(16.9)	(11.3)	11.8	(19.4)	(12.6)	2.9	24.6	14.8	0.6	0.5	6.3	5.8	2.5	5.2	2.3	3.8	2.0	3.4	4.0	4.9
US																									
Nucor Corp	NUE US	USD	49.5	Not rated	15,744	14.6	2.4	9.3	(4.4)	1.8	8.4	36.3	15.5	2.1	1.9	12.4	7.8	13.0	9.9	5.5	12.4	3.0	3.0	4.7	8.8
United States Steel	X US	USD	23.5	Not rated	3,402	(1.4)	18.4	31.1	(20.4)	17.8	30.2	(16.6)	30.5	0.9	0.9	8.9	6.0	5.9	5.1	(5.5)	3.5	0.9	0.9	0.4	2.1
Steel Dynamics	STLD US	USD	17.2	Not rated	3,802	25.4	2.6	12.3	6.4	2.0	11.3	20.4	11.8	1.5	1.4	9.1	6.6	11.2	8.2	7.5	11.9	2.5	2.5	5.5	8.3
Other																									
Arcelor Mittal	MT NA	EUR	11.3	Not rated	26,508	(12.8)	7.2	22.3	(24.2)	5.9	18.1	(32.6)	12.7	0.4	0.4	7.0	5.8	4.9	3.7	(1.3)	2.6	1.9	2.3	2.4	3.9
Steel Authority Of India	SAIL IN	INR	57.5	Outperform	3,845	(36.6)	16.9	19.0	(42.3)	12.7	16.5	6.9	6.5	0.6	0.5	6.6	6.4	3.7	3.0	8.3	8.2	2.5	2.6	10.6	11.0
Tata Steel	TATA IN	INR	310.5	Buy	4,882	(27.5)	4.1	20.6	(33.3)	(0.0)	18.0	(4.3)	7.9	1.3	1.2	7.1	6.3	2.2	2.8	1.0	10.0	2.4	3.1	5.0	6.1
Global average					10,930	7.0	2.4	15.2	(6.7)	0.9	11.1	7.0	10.2	0.9	0.9	8.5	7.1	4.8	4.5	4.9	7.6	2.0	2.3	4.7	6.0

Source: Bloomberg, *Daiwa forecasts

Note: 1) Share prices are as at 15 October 2013 (US and others as of 14 October 2013), 2) **Relative to each country index

■ **POSCO: 3Q13 earnings preview**

(KRWbn)	3Q13E Daiwa	3Q13E BBG	Diff (%)	3Q12	YoY (%)	2Q13	QoQ (%)
Revenue	15,111	15,539	(2.8)	15,739	(4.0)	15,603	(3.2)
Operating profit	695	734	(5.3)	997	(30.3)	903	(23.0)
Operating-profit margin (%)	4.6	4.7		6.3		5.8	
Net profit	634	643	(1.5)	723	(12.4)	241	163.5
NP margin (%)	4.2	4.1		4.6		1.5	

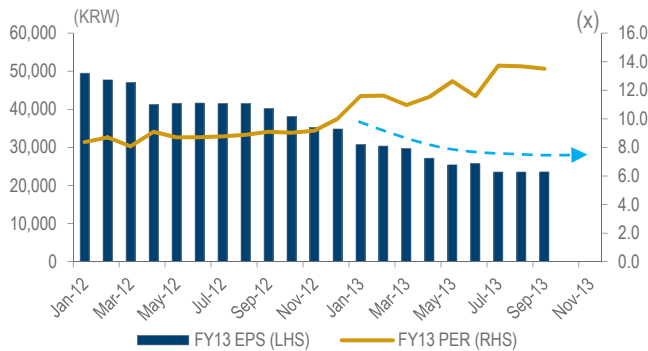
Source: Company, Bloomberg, Daiwa forecasts

■ **POSCO: major changes to assumptions**

	2013E			2014E			2015E		
	New	Prev.	% Chg	New	Prev.	% Chg	New	Prev.	% Chg
Total shipments ('000 tonnes)	34,162	34,267	0%	35,317	33,893	4%	36,916	36,086	2%
Carbon steel ASP ('000 KRW)	793	810	-2%	788	818	-4%	790	818	-3%
HRC shipments ('000 tonnes)	7,481	7,728	-3%	8,262	8,060	3%	8,579	8,148	5%
HRC ASP ('000 KRW)	696	680	2%	695	677	3%	695	660	5%
Iron ore: input price (USD/tonne)	127	128	-1%	127	137	-8%	121	138	-12%
Coking coal: input price (USD/ tonne)	165	172.0	-4%	150	182	-18%	148	182	-19%
COGS (KRWtn)	53,658	55,529	-3%	54,722	56,163	-3%	56,983	58,094	-2%

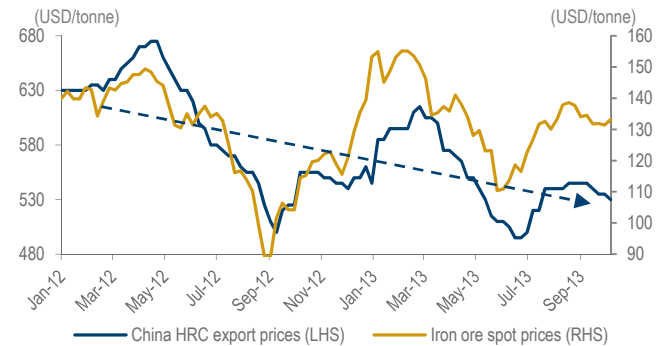
Source: Daiwa forecasts

■ **POSCO: consensus EPS and PER forecast revisions**



Source: Bloomberg

■ **China HRC export prices & iron-ore spot prices**



Source: Bloomberg

Note: Iron ore spot prices = China import iron ore fines 62% Fe from Australia

Financial summary

■ Key assumptions

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
HRC price (KRW '000/tonne)	n.a.	708,061	783,937	847,419	758,418	695,947	695,348	695,345
HRC shipment ('000 tonne)	n.a.	7,642	7,757	8,036	8,136	7,481	8,262	8,579
CRC price (KRW '000/tonne)	n.a.	833,081	924,329	1,026,734	943,059	827,234	806,696	776,622
CRC shipment ('000 tonne)	n.a.	10,568	12,779	13,084	13,544	14,175	13,870	14,189
Iron Ore price (USD/tonne)	n.a.	69	113	163	132	121	120	119
Coking coal price (USD/ tonne)	n.a.	141	173	290	213	159	148	146

■ Profit and loss (KRWbn)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Steel / Support	0	0	46,666	57,251	52,869	47,931	49,000	51,010
Trading	0	0	9,410	28,623	26,414	25,066	25,818	26,145
Other Revenue	41,743	36,855	4,562	(16,935)	(15,679)	(11,064)	(10,570)	(10,698)
Total Revenue	41,743	36,855	60,638	68,939	63,604	61,933	64,248	66,458
Other income	0	0	0	0	0	0	0	0
COGS	(32,562)	(31,037)	(51,561)	(59,824)	(56,143)	(53,658)	(54,722)	(56,983)
SG&A	(470)	(451)	(752)	(832)	(927)	(902)	(936)	(968)
Other op.expenses	(1,537)	(1,499)	(2,587)	(2,816)	(2,881)	(4,167)	(4,798)	(4,356)
Operating profit	7,174	3,868	5,738	5,468	3,653	3,206	3,793	4,150
Net-interest inc./(exp.)	(92)	(256)	(328)	(572)	(593)	(628)	(665)	(704)
Assoc/forex/extraord./others	(987)	127	(72)	(113)	308	281	737	688
Pre-tax profit	6,096	3,739	5,338	4,782	3,368	2,859	3,865	4,134
Tax	(1,734)	(536)	(1,113)	(1,068)	(983)	(604)	(773)	(827)
Min. int./pref. div./others	0	0	0	0	0	0	0	0
Net profit (reported)	4,362	3,203	4,225	3,714	2,386	2,255	3,092	3,307
Net profit (adjusted)	4,362	3,203	4,225	3,714	2,386	2,255	3,092	3,307
EPS (reported)(KRW)	50,027	36,740	48,457	42,601	27,362	25,862	35,462	37,932
EPS (adjusted)(KRW)	50,027	36,740	48,457	42,601	27,362	25,862	35,462	37,932
EPS (adjusted fully-diluted)(KRW)	50,027	36,740	48,457	42,601	27,362	25,862	35,462	37,932
DPS (KRW)	10,000	8,000	10,000	10,000	10,000	8,000	8,000	8,000
EBIT	7,174	3,868	5,738	5,468	3,653	3,206	3,793	4,150
EBITDA	9,367	5,834	9,001	9,087	7,052	6,516	7,226	7,701

■ Cash flow (KRWbn)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Profit before tax	6,096	3,739	5,338	4,782	3,368	2,859	3,865	4,134
Depreciation and amortisation	2,193	1,966	3,263	3,620	3,399	3,310	3,433	3,551
Tax paid	(1,734)	(536)	(1,113)	(1,068)	(983)	(604)	(773)	(827)
Change in working capital	(3,291)	124	1,321	(4,318)	2,160	261	(984)	(1,170)
Other operational CF items	423	3,340	(6,784)	(1,398)	(626)	381	(290)	(274)
Cash flow from operations	3,687	8,633	2,025	1,619	7,319	6,206	5,251	5,415
Capex	(4,093)	(6,407)	(5,896)	(5,331)	(7,055)	(7,231)	(4,339)	(4,122)
Net (acquisitions)/disposals	(1,411)	(3,398)	2,774	(43)	(522)	(502)	(573)	(601)
Other investing CF items	(299)	88	(3,768)	(143)	1,407	(37)	(376)	(376)
Cash flow from investing	(5,803)	(9,717)	(6,890)	(5,517)	(6,169)	(7,770)	(5,287)	(5,098)
Change in debt	3,785	1,339	5,868	5,634	68	1,206	1,266	1,329
Net share issues/(repurchases)	0	0	0	0	0	0	0	0
Dividends paid	(755)	(689)	(693)	(771)	(752)	(697)	(697)	(697)
Other financing CF items	87	212	504	37	(224)	2,334	(32)	(374)
Cash flow from financing	3,117	862	5,679	4,900	(908)	2,843	536	257
Forex effect/others	0	0	0	0	0	0	0	0
Change in cash	1,001	(222)	814	1,002	243	1,278	500	574
Free cash flow	(406)	2,226	(3,871)	(3,712)	265	(1,025)	913	1,293

Source: FactSet, Daiwa forecasts

Financial summary continued ...

■ **Balance sheet (KRWbn)**

As at 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Cash & short-term investment	5,698	8,744	7,058	7,016	6,846	8,247	8,899	9,613
Inventory	8,662	5,153	9,803	12,284	10,585	11,030	11,096	11,555
Accounts receivable	6,433	5,593	8,681	12,557	12,541	10,666	11,243	11,630
Other current assets	1,295	740	1,181	1,700	1,595	1,675	1,758	1,846
Total current assets	22,088	20,230	26,723	33,557	31,566	31,618	32,997	34,644
Fixed assets	18,069	21,840	25,699	28,453	32,276	34,987	35,892	36,463
Goodwill & intangibles	724	630	3,161	5,245	5,662	5,945	6,243	6,555
Other non-current assets	6,080	7,612	12,362	11,154	9,761	10,511	11,324	12,207
Total assets	46,961	50,312	67,946	78,409	79,266	83,062	86,457	89,869
Short-term debt	3,586	3,543	8,780	10,363	9,610	10,091	10,595	11,125
Accounts payable	3,650	3,377	5,035	5,896	5,656	5,939	6,236	6,548
Other current liabilities	3,773	2,355	3,274	3,347	4,509	4,058	3,652	3,287
Total current liabilities	11,009	9,275	17,089	19,605	19,775	20,087	20,483	20,959
Long-term debt	6,960	8,290	10,678	16,394	14,504	15,229	15,990	16,790
Other non-current liabilities	648	1,083	2,977	1,679	2,558	4,837	4,750	4,320
Total liabilities	18,617	18,647	30,745	37,679	36,836	40,153	41,223	42,069
Share capital	482	482	482	482	482	482	482	482
Reserves/R.E./others	27,862	31,182	36,719	40,248	41,947	42,426	44,751	47,317
Shareholders' equity	28,344	31,664	37,201	40,730	42,429	42,908	45,234	47,800
Minority interests	0	0	0	0	0	0	0	0
Total equity & liabilities	46,961	50,312	67,946	78,409	79,266	83,062	86,457	89,869
EV	32,094	30,335	39,645	46,987	44,514	44,318	44,932	45,548
Net debt/(cash)	4,848	3,089	12,400	19,741	17,268	17,072	17,686	18,302
BVPS (KRW)	325,097	363,178	426,686	467,157	486,649	492,143	518,814	548,243

■ **Key ratios (%)**

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Sales (YoY)	32.1	(11.7)	64.5	13.7	(7.7)	(2.6)	3.7	3.4
EBITDA (YoY)	42.2	(37.7)	54.3	1.0	(22.4)	(7.6)	10.9	6.6
Operating profit (YoY)	45.8	(46.1)	48.3	(4.7)	(33.2)	(12.2)	18.3	9.4
Net profit (YoY)	20.3	(26.6)	31.9	(12.1)	(35.8)	(5.5)	37.1	7.0
Core EPS (fully-diluted) (YoY)	20.3	(26.6)	31.9	(12.1)	(35.8)	(5.5)	37.1	7.0
Gross-profit margin	22.0	15.8	15.0	13.2	11.7	13.4	14.8	14.3
EBITDA margin	22.4	15.8	14.8	13.2	11.1	10.5	11.2	11.6
Operating-profit margin	17.2	10.5	9.5	7.9	5.7	5.2	5.9	6.2
Net profit margin	10.4	8.7	7.0	5.4	3.8	3.6	4.8	5.0
ROAE	16.3	10.7	12.3	9.5	5.7	5.3	7.0	7.1
ROAA	10.5	6.6	7.1	5.1	3.0	2.8	3.6	3.8
ROCE	20.7	9.4	11.5	8.8	5.5	4.8	5.4	5.6
ROIC	17.4	9.8	10.8	7.7	4.3	4.2	4.9	5.1
Net debt to equity	17.1	9.8	33.3	48.5	40.7	39.8	39.1	38.3
Effective tax rate	28.4	14.3	20.8	22.3	29.2	21.1	20.0	20.0
Accounts receivable (days)	46.7	59.5	43.0	56.2	72.0	68.4	62.2	62.8
Current ratio (x)	2.0	2.2	1.6	1.7	1.6	1.6	1.6	1.7
Net interest cover (x)	78.2	15.1	17.5	9.6	6.2	5.1	5.7	5.9
Net dividend payout	20.0	21.8	20.6	23.5	36.5	30.9	22.6	21.1
Free cash flow yield	n.a.	8.2	n.a.	n.a.	1.0	n.a.	3.4	4.7

Source: FactSet, Daiwa forecasts

■ **Company profile**

POSCO is the world's fourth-largest steel company and the third-largest steel company in Asia, after Nippon steel and Baosteel. POSCO's total crude-steel production was 33.7m tonnes in 2010, making the company the largest steel producer in Korea. POSCO has high economies of scale, given that it produces a total quantity of 34m tonnes at only two plants (Pohang and Kwangyang) and has storage and docking facilities.

Share price and Daiwa recommendation trend

■ **POSCO: share price and Daiwa recommendation trend**

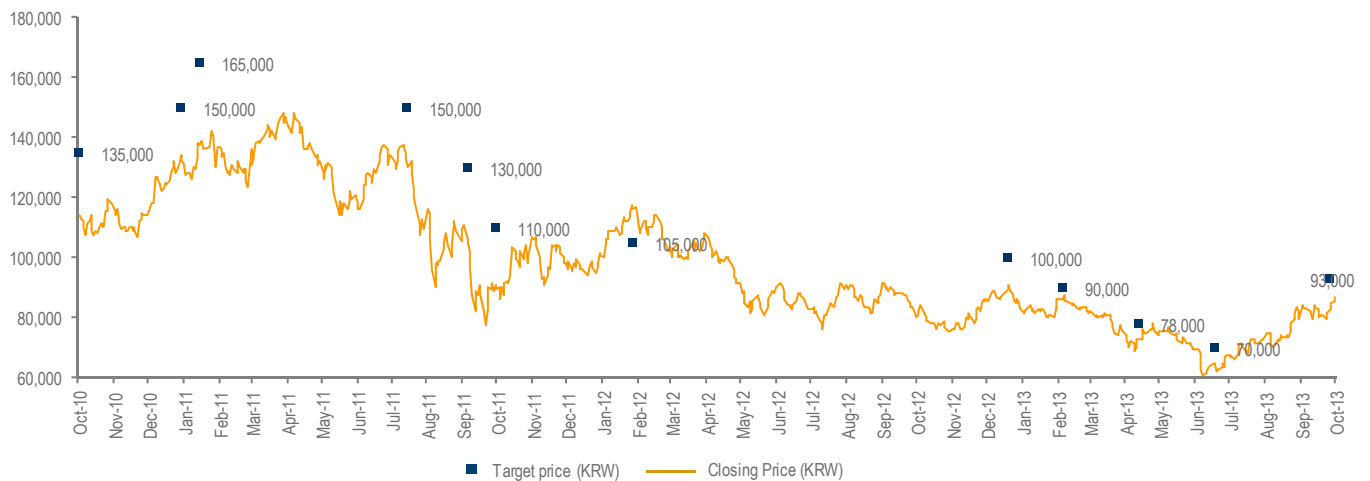
Date	Target price	Rating	Date	Target price	Rating	Date	Target price	Rating
13/01/11	530,000	Outperform	04/07/11	480,000	Hold	24/07/12	360,000	Hold
28/03/11	580,000	Outperform	21/10/11	380,000	Hold	30/01/13	320,000	Hold



Source: Daiwa

■ **Hyundai Steel: share price and Daiwa recommendation trend**

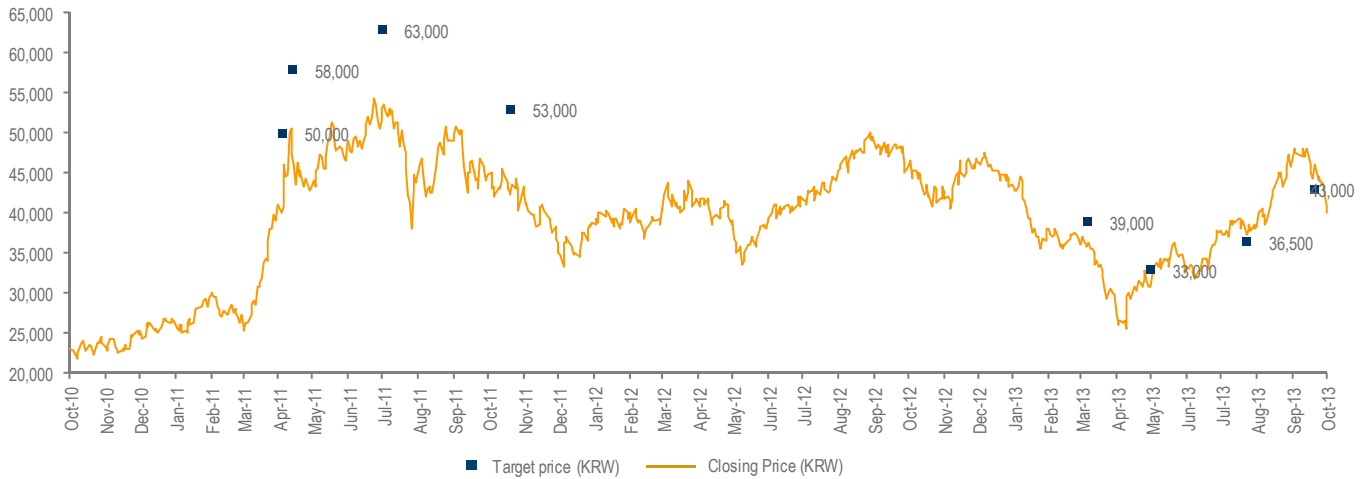
Date	Target price	Rating	Date	Target price	Rating	Date	Target price	Rating
28/01/11	165,000	Outperform	10/02/12	105,000	Underperform	19/02/13	90,000	Hold
28/07/11	150,000	Outperform	27/04/12	105,000	Hold	26/04/13	78,000	Hold
19/09/11	130,000	Outperform	12/06/12	105,000	Buy	01/07/13	70,000	Hold
13/10/11	110,000	Outperform	02/01/13	100,000	Outperform	10/10/13	93,000	Outperform



Source: Daiwa

■ **Hyundai Hysco: share price and Daiwa recommendation trend**

Date	Target price	Rating	Date	Target price	Rating	Date	Target price	Rating
18/04/11	50,000	Buy	03/11/11	53,000	Buy	06/08/13	36,500	Hold
27/04/11	58,000	Buy	20/03/13	39,000	Hold	04/10/13	43,000	Hold
14/07/11	63,000	Buy	14/05/13	33,000	Hold			



Source: Daiwa

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