Korea Kumho Petrochemical

011780 KS

Target price: **W190,000 → W220,000** Up/downside: **+20.2%** Share price (14 Apr): **W183,000**

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

1Q11 earnings surprise... we expect a stronger 2Q11

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- K-GAAP-based 1Q11 operating profit beat the Bloomberg consensus by 40%
- We forecast the K-GAAP-based 2Q11 operating profit to rise by 150% YoY and 11% QoQ
- TP raised by 16% to W220,000

What's new

Korea Kumho Petrochemical (KKP) recorded an all-time-high K-GAAP-based operating profit of W223bn for 1Q11, beating our forecast and that of the Bloomberg consensus by 16% and 40%, respectively, on the back of the synthetic-rubber price rally.

KKP: K-GAAP 1Q11 results (Wbn)

	1Q11	QoQ (%)	YoY (%)	Daiwa diff (%)	Consensus diff (%)
Sales	1,252.0	22.5	41.2	(2.3)	4.5
Operating profit	222.9	111.7	243.2	15.8	39.5
Net profit	185.6	(21.4)	120.8	15.4	25.7

Source: Company, Bloomberg, Daiwa forecasts

KKP: IFRS 1Q11 results (Wbn)

	1Q11	4Q10	1Q10	QoQ (%)	YoY (%)
Sales	1,600.2	1,263.1	1,147.9	26.7	39.4
Operating profit	288.5	164.9	125.1	75.0	130.6
Net profit	185.6	76.0	82.1	144.2	126.1

Source: Company

The IFRS-based 1Q11 operating profit was W289bn. This figure includes an additional operating profit of W65bn from KKP's subsidiary, Kumho P&B Chemicals.

What's the impact

All-time-high first-quarter operating profit: The 1Q11 earnings surprise was due mainly to a better-than-expected operating profit for the synthetic-rubber business, which was 18% higher than our forecast.

We believe the key reason behind the better synthetic-rubber earnings was a positive lag effect of raw-material price rises, which probably resulted in a higher synthetic-rubber price spread than our forecast. Generally, raw-material price changes are recognised as input costs with a 1-2 month lag.

We expect stronger 2Q11 earnings: We have revised up our K-GAAP-based 2011 operating-profit forecast by 19% to W831bn, to reflect the 1Q11 results and our better 2Q11 and 2H11 outlook, on a stronger-than-expected synthetic-rubber price. We now forecast the K-GAAP-based 2Q11 operating profit to rise by 150% YoY and 11% QoQ to W247bn.

Synthetic-butadiene-rubber (SBR) spot prices are expected to reach US$4,079-4,409/tonne for May deliveries in Europe (versus KKP's 1Q11 average contract price of US$2,914/tonne and its April contract price of US$3,600/tonne), according to ICIS News, due to strong tyre demand amid tight synthetic-rubber supplies. For the first two months of 2011, OE and RE tyre demand rose by 9% YoY and 14% YoY, respectively, for passenger cars and light trucks in Europe.

As we expect strong tyre demand from Europe and the US to improve the synthetic-rubber supply/demand dynamics, especially taking into account the peak summer demand, we have revised up our 2Q11 synthetic-rubber price forecasts by US$300/tonne to US$4,300/tonne for BR, and by US$233/tonne to US$3,733/tonne for SBR.

What we recommend

We raise our SOTP-based six-month target price to W220,000 (from W190,000); **1** (Buy) maintained. Risks may include weak tyre sales and a sharp rise in butadiene prices.

How we differ

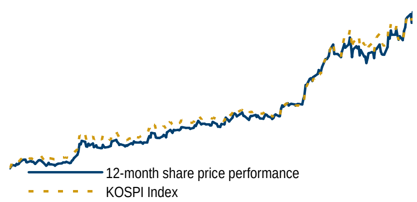
Our 2011E EPS is 13% above consensus on stronger synthetic-rubber supply/demand dynamics.

Forecast revisions (%)

Year to 31 Dec	11E	12E	13E
Revenue change	4.0	(0.1)	0.0
Net-profit change	18.1	0.5	0.6
EPS change	18.1	0.5	0.6

Source: Daiwa forecasts

Share price performance



12-month range	30,400-175,000
Market cap (US$bn)	5.12
Average daily turnover (US$m)	42.52
Shares outstanding (m)	30
Major shareholder	C.G. Park and related parties (42.1%)

Financial summary (W)

Year to 31 Dec	11E	12E	13E
Revenue (bn)	5,304	4,920	4,982
Operating profit (bn)	831	646	678
Net profit (bn)	682	558	608
Core EPS	22,400	18,319	19,959
EPS change (%)	44.8	(18.2)	8.9
Daiwa vs Cons. EPS (%)	13.1	(6.2)	(6.5)
PER (x)	8.2	10.0	9.2
Dividend yield (%)	0.5	0.5	0.5
DPS	1,000	1,000	1,000
PBR (x)	3.2	2.5	2.0
ROE (%)	52.4	28.1	23.9

Source: Bloomberg, Daiwa forecasts

Financial summary

Key assumptions

Year to 31 Dec	2006	2007	2008	2009	2010	2011E	2012E	2013E
SBR spread (US$/tonne)	258	505	549	486	487	1,113	1,161	1,268
BR spread (US$/tonne)	278	589	847	519	691	1,219	1,204	1,439
SBR price (US$/tonne)	1,533	1,589	2,320	1,441	2,147	3,362	2,920	2,888
BR price (US$/tonne)	1,648	1,653	2,872	1,520	2,582	3,862	3,163	3,200
S. Rubber div. OP (Wbn)	46	120	242	54	209	644	461	489
Resin div. OP (Wbn)	(9)	(5)	(28)	37	74	98	88	82

Profit and loss (Wbn)

Year to 31 Dec	2006	2007	2008	2009	2010	2011E	2012E	2013E
Synthetic rubber	892	1,096	1,886	1,479	2,234	3,471	3,032	3,012
Synthetic resin	721	878	1,028	1,010	1,220	1,391	1,405	1,425
Others	140	151	269	313	432	443	483	545
Total revenue	1,753	2,125	3,182	2,802	3,886	5,304	4,920	4,982
Other income	0	0	0	0	0	0	0	0
COGS	(1,542)	(1,812)	(2,703)	(2,488)	(3,306)	(4,175)	(3,981)	(4,005)
SG&A	(124)	(151)	(199)	(198)	(221)	(299)	(294)	(299)
Other op. expenses	0	0	0	0	0	0	0	0
Operating profit	87	161	281	116	360	831	646	678
Net-interest inc./(exp.)	(53)	(75)	(86)	(106)	(117)	(95)	(66)	(46)
Assoc/forex/extraord./others	79	91	(222)	(852)	352	154	149	161
Pre-tax profit	113	177	(27)	(842)	595	890	728	793
Tax	(33)	(43)	7	227	(124)	(208)	(170)	(185)
Min. int./pref. div./others	0	0	0	0	0	0	0	0
Net profit (reported)	80	134	(20)	(615)	471	682	558	608
Net profit (adjusted)	80	134	(20)	(615)	471	682	558	608
EPS (reported) (W)	3,134	5,287	(777)	(24,183)	15,473	22,400	18,319	19,959
EPS (adjusted) (W)	3,134	5,287	(777)	(24,183)	15,473	22,400	18,319	19,959
EPS (adjusted fully-diluted) (W)	3,134	5,287	(777)	(24,183)	15,473	22,400	18,319	19,959
DPS (W)	700	750	750	0.000	1,000	1,000	1,000	1,000
EBIT	87	161	281	116	360	831	646	678
EBITDA	159	217	349	215	471	949	773	807

Cash flow (Wbn)

Year to 31 Dec	2006	2007	2008	2009	2010	2011E	2012E	2013E
Profit before tax	113	177	(27)	(842)	595	890	728	793
Depreciation and amortisation	72	57	68	99	111	118	128	129
Tax paid	(33)	(43)	7	227	(124)	(208)	(170)	(185)
Change in working capital	(5)	(16)	(238)	135	(105)	(66)	25	(13)
Other operational CF items	(47)	(24)	82	828	(29)	(66)	(89)	(123)
Cash flow from operations	100	151	(108)	448	448	668	622	601
Capex	(99)	(194)	(345)	(287)	(175)	(300)	(300)	(300)
Net (acquisitions)/disposals	(647)	50	(161)	(74)	77	0	0	0
Other investing CF items	18	(63)	556	361	(204)	(394)	(189)	108
Cash flow from investing	(728)	(207)	50	0	(302)	(694)	(489)	(192)
Change in debt	528	155	163	(261)	2	274	24	(59)
Net share issues/(repurchases)	0	0	0	0	0	0	0	0
Dividends paid	(15)	(16)	(17)	(17)	0	(23)	(28)	(28)
Other financing CF items	0	0	0	0	0	0	0	0
Cash flow from financing	513	139	146	(278)	2	251	(5)	(88)
Forex effect/others	0	0	0	0	0	0	0	0
Change in cash	(116)	83	88	170	148	226	128	322
Free cash flow	1	(43)	(453)	161	273	368	322	301

Source: Company, Daiwa forecasts

Financial summary continued ...

Balance sheet (Wbn)

As at 31 Dec	2006	2007	2008	2009	2010	2011E	2012E	2013E
Cash & short-term investment	3	12	13	106	115	246	308	584
Inventory	243	257	369	321	371	416	396	403
Accounts receivable	180	198	337	299	368	423	404	415
Other current assets	36	22	64	50	37	46	44	45
Total current assets	462	489	783	776	891	1,131	1,151	1,447
Fixed assets	576	727	1,273	1,357	1,423	1,616	1,795	1,980
Goodwill & intangibles	45	47	45	36	26	17	11	7
Other non-current assets	1,532	1,588	1,613	1,032	1,096	1,096	1,096	1,096
Total assets	2,615	2,851	3,715	3,200	3,436	3,860	4,053	4,530
Short-term debt	492	344	661	1,507	1,141	686	419	488
Accounts payable	183	201	213	263	276	310	295	301
Other current liabilities	120	168	243	290	278	400	381	392
Total current liabilities	795	713	1,117	2,059	1,695	1,396	1,095	1,180
Long-term debt	876	1,134	1,308	585	858	736	700	513
Other non-current liabilities	171	138	127	21	2	2	2	2
Total liabilities	1,842	1,985	2,552	2,665	2,555	2,135	1,798	1,695
Share capital	142	142	142	142	142	152	152	152
Reserves/R.E./others	631	724	1,021	393	738	1,572	2,102	2,682
Shareholders' equity	773	866	1,163	535	880	1,725	2,255	2,835
Minority interests	0	0	0	0	0	0	0	0
Total equity & liabilities	2,615	2,851	3,715	3,200	3,436	3,860	4,053	4,530
Net debt/(cash)	1,365	1,466	1,955	1,986	1,884	1,176	811	416
BVPS (W)	30,401	34,059	45,749	21,047	28,894	56,607	74,006	93,044

Key ratios (%)

Year to 31 Dec	2006	2007	2008	2009	2010	2011E	2012E	2013E
Sales (YoY)	2.6	21.2	49.8	(12.0)	38.7	36.5	(7.2)	1.3
EBITDA (YoY)	(11.1)	37.0	60.5	(38.3)	118.5	101.6	(18.5)	4.4
Operating profit (YoY)	(27.8)	84.9	75.0	(58.7)	209.5	131.2	(22.3)	5.0
Net profit (YoY)	(34.4)	68.7	n.a.	n.a.	n.a.	44.8	(18.2)	8.9
EPS (YoY)	(34.4)	68.7	n.a.	n.a.	n.a.	44.8	(18.2)	8.9
Gross-profit margin	12.1	14.7	15.1	11.2	14.9	21.3	19.1	19.6
EBITDA margin	9.1	10.2	11.0	7.7	12.1	17.9	15.7	16.2
Operating-profit margin	5.0	7.6	8.8	4.1	9.3	15.7	13.1	13.6
ROAE	9.9	16.4	n.a.	n.a.	66.6	52.4	28.1	23.9
ROAA	3.5	4.9	n.a.	n.a.	14.2	18.7	14.1	14.2
ROCE	4.7	7.2	10.3	4.0	13.1	27.6	19.8	18.8
ROIC	3.5	5.5	10.3	4.1	10.8	22.5	16.6	16.5
Net debt to equity	176.6	169.3	168.1	371.1	214.0	68.2	36.0	14.7
Effective tax rate	29.3	24.2	n.a.	n.a.	20.8	23.3	23.3	23.3
Accounts receivable (days)	37.4	34.0	38.6	38.9	34.6	29.1	29.9	30.4
Payables (days)	38.1	34.5	24.4	34.2	26.0	21.4	21.9	22.0
Net interest cover (x)	1.6	2.2	3.3	1.1	3.1	8.8	9.7	14.7
Net dividend payout	22.3	14.2	n.a.	n.a.	6.5	4.5	5.5	5.0

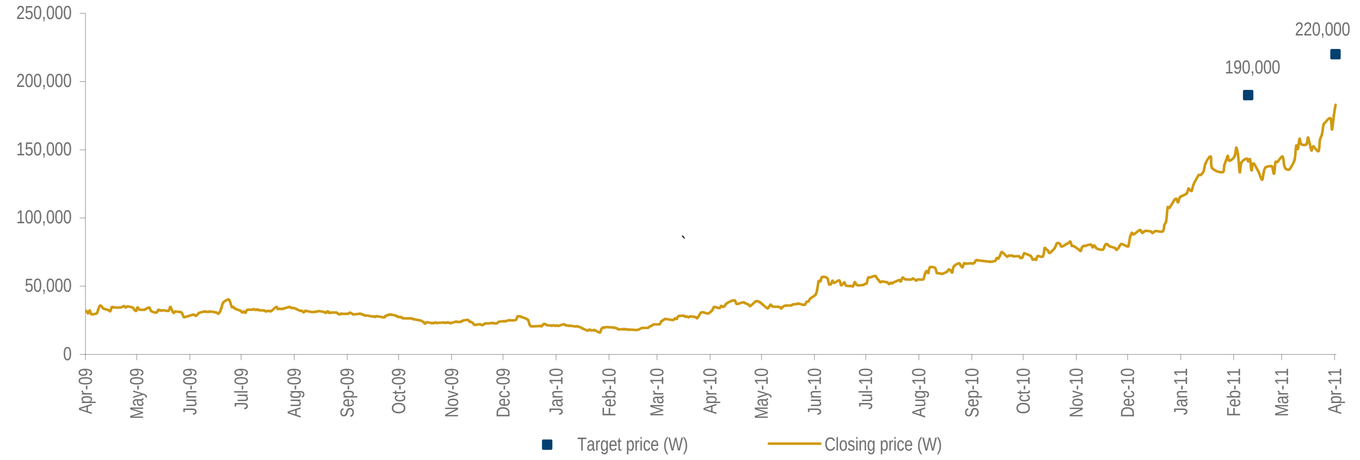
Source: Company, Daiwa forecasts

Company profile

Korea Kumho Petrochemical (KKP) focuses on core businesses, namely, synthetic rubber and resin production. Over the past 39 years, KKP has developed into the leading producer of synthetic rubber globally and is actively expanding its business areas to synthetic resins and fine chemical industry, construction material manufacturing, etc. Synthetic rubber accounted for 58% of operating profit for 2010, while resin accounted for 21%.

■ **Korea Kumho Petrochemical: share price and Daiwa recommendation trend**

Date	4/14/2011	2/22/2011
Target price	220,000	190,000
Rating	1	1



Source: Daiwa

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