RISK MANAGEMENT

In business, crises and opportunities are inevitable. That is why rigorous risk management is a key factor in ensuring a company's continued long-term success. At KKPC, our risk management system excels at identifying and analyzing risk in advance to ensure an appropriate response, enabling us to both prevent as well as effectively respond to incidents.

Currency Risk

The Korean won continued to appreciate in 2010 as volatility and uncertainty in global markets slightly increased in the wake of the financial crises in Europe and geopolitical instability. Approximately 80% of total 2010 sales was in foreign currencies, including 65% from direct exports and 15% from local sales. About 88% of overseas sales were in US dollars.

In 2011, we plan to take a long cash position of roughly USD 190 million based on our feedstock import requirements and foreign-denominated assets and liabilities. In this scenario, each KRW 10 change in the exchange rate will impact profitability by roughly KRW 1.9 billion. Our 2011 business plans and targets are based on an average exchange rate of KRW 1,050 to the US dollar. With the average rate holding above KRW 1,100 at the end of the first quarter of 2011, we expect the rate to have little or no impact on our ability to achieve our business targets.

Market Risk

Demand in downstream industries recovered to pre-financial crisis levels in 2010, lifted by growth in emerging markets such as China and India as well as recovering demand in developed markets in North America and Europe. With demand projected to steadily increase as tire, home appliance, and auto makers raise their operating rates in 2011, we expect to see growth in sales, sales volume, and profitability. On the other hand, there are a number of areas of concern. There is still considerable external risk due to the European financial crisis and the possibility of an oil shock due to political instability in the Middle East and Africa as well as fluctuation risk for both product pricing and profitability. Our proactive response to these rapidly changing market conditions includes reallocating regional sales quotas and maintaining pricing flexibility. As we shift our product mix toward value-added, eco-friendly products and strengthen our market leadership, we will also be aiming to establish ourselves in potential growth markets as we continue to deliver profitable growth.

Raw Materials Risk

In the first half of 2010, prices for butadiene (BD)—the primary feedstock used in synthetic rubbers (BR, SBR) and synthetic resins (ABS) moved higher as oil, naphtha, and natural rubber prices rose and exports from Asia kept regional supply tight. In the second half of the year, BD prices leveled out as new capacity came on-stream in Asia, holding steady at around the USD 2,000 per metric ton. In the first half of 2011, scheduled maintenance shutdowns by regional manufacturers and continued exports from Asia are expected to push BD prices higher. The projected average BD price for 2011 is USD 2,500 per metric ton.

As synthetic rubber production volume increases, BD supply is becoming proportionally more important. Recently, suppliers of mixed C4—the feedstock used to make BD—have started building their own BD plants to improve profitability, resulting in a partial reduction of the mixed C4 supply volume. We are currently sourcing our mixed C4 shortfall from overseas. Looking ahead, we will continue to diversify our suppliers, participate in joint-venture BD plant construction, and adopt new BD production processes as we take a comprehensive approach to increasing our BD self-supply ratio.

Financial Risk

In 2010, we continued to pay off our short-term borrowings, pushing our debt-to-equity ratio down from 498% at the end of 2009 to 290% at the end of 2010. Our sharp increase in sales and operating income improved our asset turnover and interest coverage ratios, boosting all measures of financial soundness as the company normalization process proceeded smoothly.

In 2011, we plan to use our operating cash flow to reduce net borrowings to around KRW 1,500 billion, reducing our debt-to-equity ratio to under 200%. If necessary, we will gradually sell off equity stakes in affiliates such as Asiana Airlines and Daewoo Engineering & Construction that have been designated as available-for-sale securities. In order to wrap up our MOUs with creditor banks related to the company normalization plan ahead of schedule, we have set a conservative investment plan of KRW 100 billion as we continue to focus on research and business development as well as building production facilities for promising fields such as carbon nanotube and building materials as we invest in tomorrow's growth engines.

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