LEADING Research

Hyundai Hysco (010520 KS)

October 8, 2012

Top pick among steel companies, but limited upside potential in stock price

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Leading Traffic Light: Yellow

Hyundai Hysco is…

- ✓ Supplying over 90% of its auto-sheets to Hyundai/Kia Motors
- ✓ Increasing its auto-sheet capacity by 46% with the construction of its No.2 plant

Yellow light because:

- ✓ Sales growth and stable profit margin driven by captive demand are positive, but these positives are mostly priced in

Growth:

- ➢ Revenue is expected to increase 13% yoy in 2013 thanks to capacity addition
- ➢ The company needs to secure an additional clientele other than Hyundai/Kia Motors

Profitability:

- ➢ Profitability is stable despite decline in CR price due to oversupply in the HRC market
- ➢ Profit margin will improve, if the company substitutes its auto-sheet merchandise sales with its own manufactured products

Steel Industry Overview:

- ➢ After price decrease in 4Q12, sluggish market condition will continue until 1H13
- ➢ We advise investors to maintain a conservative view on the steel industry in the meantime

Valuation:

- ➢ The company deserves a premium given its stable business environment relative to its peers
- ➢ Target price of W53,000 by applying the PER of 13.2x to the company's 12-month forward EPS (a 10.0% upside potential)
- ➢ We initiate coverage with a HOLD rating

CAVEAT EMPTOR!!! – Watch out for…

- ➢ More than 40% of output from its new plant should be sold to automakers besides Hyundai Motor Group
- ➢ If substitution of own manufactured product for merchandise sales is delayed, the company will be more burdened with sales pressure

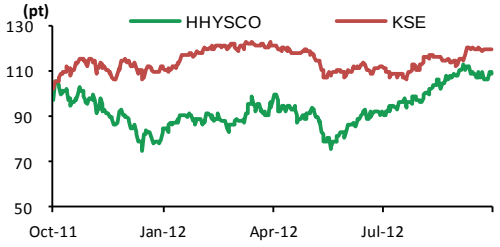
HOLD

Target Price (KRW)	**W53,000**
Current Price (KRW)	**W48,200**
Upside Potential (%)	**10.0%**

Key Data	**October 5, 2012**
Sector	Materials
KOSDAQ	1,995.17
Market Cap. (Wbn)	3,865.6
Shares Outstanding (m)	80.2
Foreign Ownership (%)	22.9
52 Week High (KRW)	50,200
Low (KRW)	33,300
60-davg. turnover (Wbn)	8.8
Major Shareholders	**(%)**
Hyundai Motor & 5 others	55.1
JFE Steel	8.0

Performance (%)	**1M**	**6M**	**12M**
Absolute	1.0	12.9	11.8
Relative	(5.4)	14.5	(4.8)

Relative Performance



Valuation Forecast

FY	Sales (Wbn)	% chg yoy	OP (Wbn)	OPM (%)	NP (Wbn)	EPS (W)	EPS Growth (%)	PER (x)	EV/EBITDA (x)	ROE (%)	P/B (x)
2009	5,238.0	(3.2)	162.8	3.1	58.3	721	278.2	66.8	15.3	5.3	3.3
2010	6,865.8	31.1	306.9	4.5	194.7	2,416	234.9	20.0	9.2	15.5	2.9
2011	8,170.3	19.0	435.1	5.3	297.8	3,699	53.1	13.0	7.2	19.9	2.4
2012E	8,828.3	8.1	487.7	5.5	328.0	4,075	10.1	11.8	7.6	18.3	2.0
2013E	9,955.4	12.8	539.8	5.4	354.1	4,392	7.8	11.0	7.1	16.8	1.7
2014E	10,747.6	8.0	606.1	5.6	424.9	5,272	20.0	9.1	5.8	17.1	1.4

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Key Check Point

✓ Hyundai Hysco is expected to maintain stable profitability despite decline in steel prices

In 3Q12, Hyundai Hysco's consolidated operating profit is likely to decline 4% QoQ due to revenue decrease from seasonal effects. OP margin is expected to remain virtually unchanged thanks to the continued oversupply in the raw material market. Non-consolidated net profit will be likely to sharply fall without dividend income unlike 2Q, however, consolidate-NP will be similar to the level in the previous quarter with decline in FX losses. In 4Q12, revenue is estimated to increase over 10% from 3Q driven by increase in working days as well as Hyundai/Kia Motors' drive to increase production to make up for production loss from the strike. This is the largest quarterly revenue for the year, and profits will exceed the 2Q level.

Hyundai/Kia Motors and POSCO are currently negotiating for 4Q12 auto-sheet price. Auto-sheet price will be likely to decline at least W30,000 per ton (3%) in 4Q. POSCO and Hyundai Steel, which produce hot-rolled coils (HRC), the raw material for auto-sheets, will bear the auto-sheet price decline. Auto-sheet profit margin for Hyundai Hysco will be similar to the level in 3Q. In 2013, profitability of steelmakers, including Hyundai Hysco, depends on recovery of the steel market in 1H13 after price decline in 4Q12. While operating profit amount will increase thanks to sales growth driven by Dangjin No.2 CR plant operation, there is currently no major factors to improve market demand/supply. Hence, profitability will be likely to slightly decease from 2012.

✓ The company needs to secure an additional clientele besides Hyundai/Kia Motors due to additional capacity

Hyundai Hysco will maintain growth and stable margin despite the sluggish steel market condition. However, we believe there are two risks related with the company's auto-sheet business environment. First, the company will have to secure an additional clientele besides Hyundai/Kia Motors to sell products from its new plant. Some expect that most of the company's additional auto-sheet products from Dangjin No.2 CR plant, will be supplied to Hyundai/Kia Motors' overseas plants, and Hyundai Hysco's share of auto-sheet supply to Hyundai/Kia Motors will increase to as high as 70%. However, a 70% share assumption is unrealistic and overly optimistic, only to exaggerate the company's captive demand based growth story. Considering automakers' practice to diversify supply channels for raw materials and parts, Hyundai Hysco's share will unlikely to exceed 55% in 2014 when Dangjin No.2 CR plant will fully operate. As a result, Hyundai Hysco should sell auto-sheets of 920,000 tons to domestic/overseas automakers besides Hyundai/Kia Motors in 2014 (300,000 tons in 2011). The increase of 620,000 tons accounts for more than 40% of additional capacity. We believe that this is a risk factor unlike the market expectations that the company will be able to sell most additional output to Hyundai/Kia Motors.

✓ Quality issue – whether manufactured auto-sheets from the new plant to substitute merchandise sales

The second risk is Hyundai Hysco's auto-sheet quality. The quality issue might be not an important investment consideration because the company maintains stable growth given captive demand in spite of the economic recession. However, quality improvement will improve profitability while reducing the burden to secure an additional clientele besides Hyundai/Kia Motors. Merchandise auto-sheets account for 17% of the company's total auto-sheet sales. Most merchandise auto-sheets are high-end products which cannot be produced from Hyundai Steel's HR. Hyundai Hysco purchases these auto-sheets from POSCO and Japanese steelmakers and supplies to Hyundai/Kia Motors. Since this is a simple delivery service, it does not generate any profit at all. Therefore, it is important whether manufactured products at the company's new plant will substitute merchandise auto-sheet sales. The company will be more burdened by sales pressure if substitution is delayed.

✓ HOLD recommendation with a target price of W53,000

Applying the target PER of 13.2x (adding the average high premium of 21% in 2 years to the market PER) to company's 12-month forward controlling shareholder EPS of W4,028, we derive the target price of W53,000. We believe that the premium of 20% is not too high given the company's growth and stable margin. Nevertheless, additional upside potential is limited due to the share price rise in recent months and therefore we recommend a HOLD on the company.

Section 1-1: Valuation – Target price of W53,000

Premium over the market given growth and stable profit

Hyundai Hysco's shares were traded with high premiums over the market on a PER valuation base in mid-2000's, but it was only due to extremely low profit levels. In 2011, the company's shares began to be revalued. The shares were traded with a premium of as high as 31% over the market given growth with captive demand. The premium decreased in 2012 due to the ongoing recession in the steel market.

HOLD recommendation – Target price of W53,000

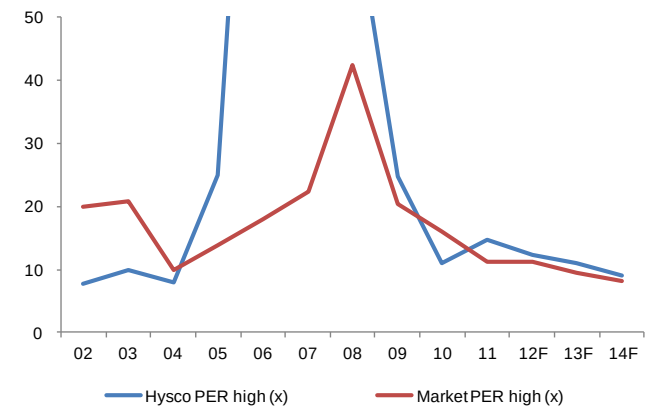
Applying the target PER of 13.2x to company's 12-month forward controlling shareholder EPS of W4,028, we derive the target price of W53,000. We add the premium of 21% over the market PER (the average of 2011 and 2012 highs) given growth and relative stability of the profit structure. However, we recommend the HOLD rating due to the limited upside to our target price.

Exhibit 1. Market PER vs. Hyundai Hysco PER trend

	03	04	05	06	07	08	09	10	11	12F	13F	14F
Hyundai Hysco PER high (x)	9.9	8.0	25.0	134.9	51.4	69.7	24.7	10.9	14.7	12.3	11.0	9.1
Market PER high (x)	20.7	9.9	13.9	17.9	22.3	42.4	20.4	16.0	11.2	11.2	9.4	8.1
Premium/Discount) to market (%)	**(52.4)**	**(19.3)**	**80.3**	**653.1**	**130.6**	**64.5**	**21.5**	**(31.7)**	**31.1**	**10.0**	**16.7**	**12.9**
Hyundai Hysco PER low (x)	5.8	3.8	10.3	73.5	31.0	26.0	7.7	6.1	6.8	8.2	11.0	9.1
Market PER low (x)	10.2	5.7	7.2	11.0	10.9	16.2	9.8	9.6	7.8	9.7	9.4	8.0
Premium/Discount) to market (%)	**(43.2)**	**(32.7)**	**42.4**	**569.0**	**184.7**	**60.4**	**(20.9)**	**(36.3)**	**(13.0)**	**(15.0)**	**16.7**	**14.6**

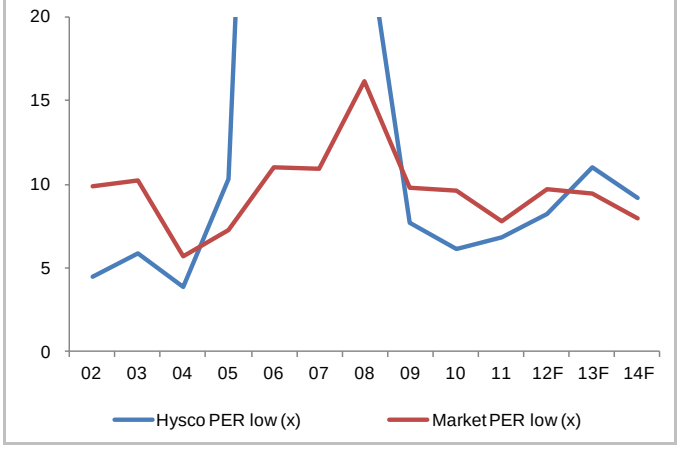
Source: FnGuide, Leading Research Center

Exhibit 2. Year-high PER trend (Hysco vs. Market)



Source: FnGuide, Leading Research Center

Exhibit 3. Year-low PER trend (Hysco vs. Market)



Source: FnGuide, Leading Research Center

Section 1-2: Valuation –Peer Valuation

The premium is not too high compared to domestic peer companies

Hyundai Hysco's shares are traded on a premium relative to major steel/metal companies except Korea Zinc on a PER valuation base. However, the premium is not too high given the company's growth and high ROE compared to peer companies. Other Asian steel mills are trading at much higher multiples than Hysco only due to low profit levels and therefore valuation comparison is not relevant.

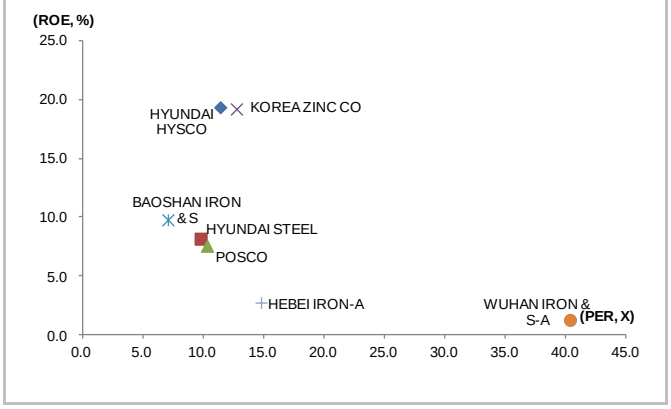
Exhibit 4. Peer valuation comparison

Company	Code	Country	Market Cap. (US$mn)	Revenue (US$mn) 10	11	12F	13F	OPM (%) 10	11	12F	13F
Hyundai Hysco	010520 KS	Korea	3,506	5,940	7,382	7,927	8,939	4.5	5.3	5.5	5.4
POSCO	005490 KS	Korea	28,755	41,433	62,287	59,353	63,025	11.6	7.9	6.1	6.5
Hyundai Steel	004020 KS	Korea	6,732	8,856	13,787	13,260	13,860	10.3	8.4	7.2	8.5
Korea Zinc	010130 KS	Korea	8,259	3,321	5,020	4,972	5,526	16.9	17.4	17.0	17.9
Baoshan	600019 CH	China	12,762	29,832	34,418	32,160	32,225	8.2	3.7	4.3	5.2
Wuhan	600005 CH	China	3,887	12,809	15,602	14,749	15,358	3.8	2.3	1.0	1.6
Hebei	000709 CH	China	3,937	18,412	20,604	20,132	20,155	2.9	2.9	0.7	1.2
NSC	5401 JP	Japan	18,881	48,089	51,848	50,018	51,724	4.0	1.9	1.8	2.1
JFE	5411 JP	Japan	7,966	37,392	40,132	39,397	41,452	5.7	1.4	1.4	2.6

Company	P/E (X) 10	11	12F	13F	EV/EBITDA (X) 10	11	12F	13F	P/B (X) 10	11	12F	13F	ROE (%) 10	11	12F	13F
Hyundai Hysco	10.3	9.4	11.9	11.1	5.6	5.7	7.6	7.2	1.5	1.7	2.0	1.7	16.1	21.2	18.3	16.8
POSCO	9.1	8.0	10.8	9.0	6.3	6.8	8.2	8.2	1.0	0.8	0.8	0.7	12.5	8.8	7.3	8.3
Hyundai Steel	11.3	10.8	9.7	8.1	12.3	8.5	8.8	7.6	1.2	0.9	0.8	0.7	12.1	8.5	8.2	9.0
Korea Zinc	8.9	7.6	12.7	10.6	6.4	4.4	7.8	6.4	1.8	1.6	2.3	1.9	21.3	22.7	19.2	19.3
Baoshan	8.8	11.5	7.0	10.2	5.8	7.5	5.1	5.0	1.1	0.8	0.7	0.7	12.6	6.6	9.8	6.9
Wuhan	17.7	26.5	40.3	20.9	7.6	8.3	7.3	6.3	1.0	0.8	0.7	0.7	6.2	3.1	1.3	2.3
Hebei	23.3	22.0	14.7	9.7	9.5	9.6	7.5	6.8	0.6	0.7	0.6	0.5	4.0	2.6	2.8	3.3
NSC	18.0	24.4			7.5	8.7	9.4	9.1	0.9	0.8	0.6	0.6	6.7	3.5	2.8	1.5
JFE	22.0			9.7	6.6	9.1	6.9	7.9	0.9	0.7	0.4	0.4	6.0	(1.9)	(0.9)	3.8

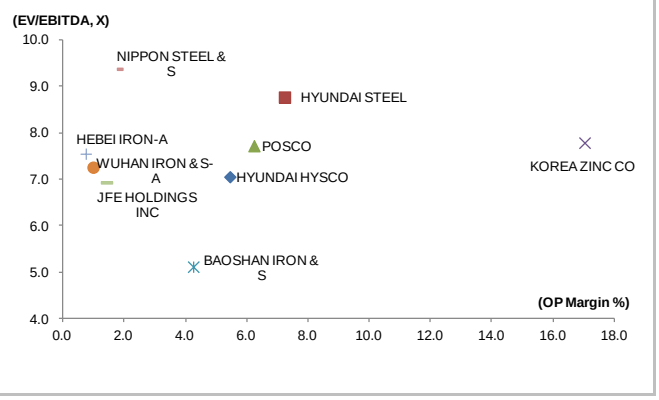
Source: Bloomberg, Leading Research Center

Exhibit 5. Peer PER vs. ROE in 2012



Source: Bloomberg, Leading Research Center

Exhibit 6. Peer EV/EBITDA vs. OPM in 2012



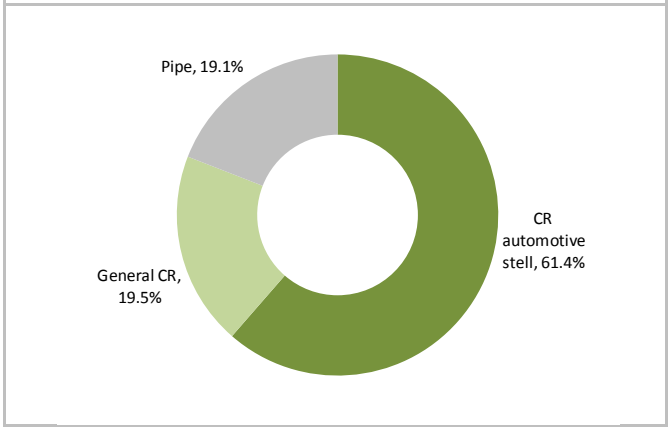
Source: Bloomberg, Leading Research Center

Section 2: Company Snapshot

Supplying over 90% of Auto-steels to Hyundai/Kia Motor

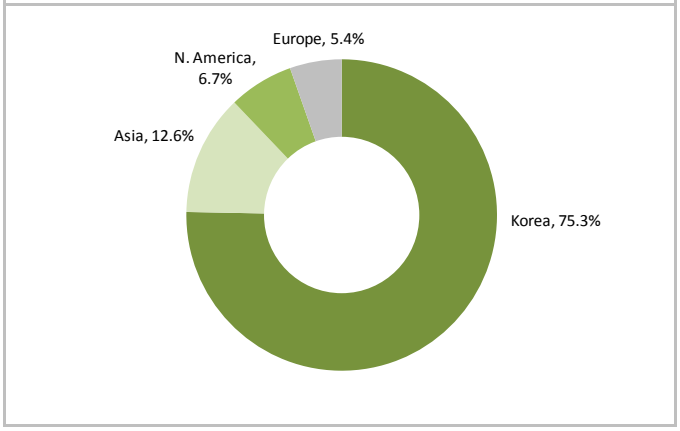
Auto-steel accounts for over 60% of Hyundai Hysco's total steel sales, and over 90% of Auto-steels are supplied to Hyundai/Kia Motors. Hyundai Hysco's share of steel sheet supply to Hyundai/Kia Motors is estimated to be 44% and 54% including merchandises. The company's CR capacity is currently 4.5m tons, and the company is constructing 1.5m tons No.2 CR plant in Dangjin which will be operated in May 2013. Sales proportion of Auto-steel will reach to 70% in 2014 with full operation of the new plant.

Exhibit 7. Sales breakdown by product (2011)



Source: Hyundai Hysco

Exhibit 8. . Sales breakdown by region (2011)



Source: Hyundai Hysco

Profitability per product – profitability of general CR and pipe is in slump

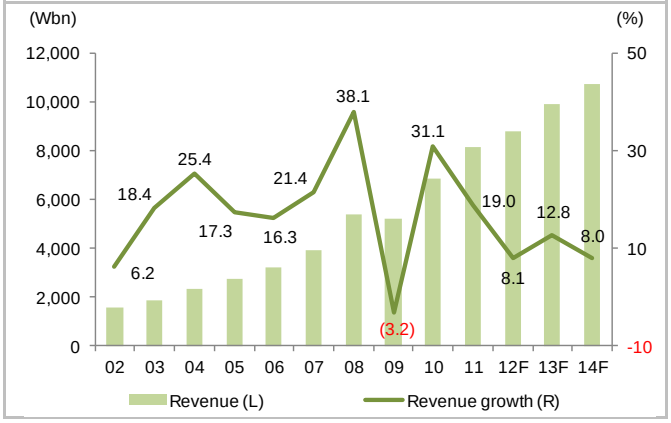
OPM of the Auto-steel unit is estimated to reach 10%. However, the general CRC unit, which constructions and home appliances are major demand sources, decrease total profitability because the unit is in the red due to slump in demand. Although profitability of the pipe unit fluctuates with input of low price raw materials, basically it is a low margin product with the margin of below 5%. Profitability of second rolling companies such as Hyundai Hysco is lower than blast furnace mills like POSCO which produce HRC, a raw material. Regardless of increase in sales volume, Hyundai Hysco is estimated to be able to generate OPM of 6% maximally.

Exhibit 9. Hyundai Hysco's overseas branches supply and 2011 earnings

(10k unit, Wbn)	Beijing	Yancheng	Tianjin	USA	India	Turkey	Slovakia	Czech	Russia	Brazil	Total	Headquarter
Supply	70	43	30	66	60	20	30	30	20	15	384	
2011												
Revenue	599.8	288.6		529.3	430.7		202.0	182.3	110.0		2,342.7	6,935.3
NP	2.3	11.6		19.2	(6.6)		7.5	4.7	(2.0)		36.7	255.4
NPM	0.4%	4.0%		3.6%	1.5%		3.7%	2.6%	1.8%		1.6%	3.7%

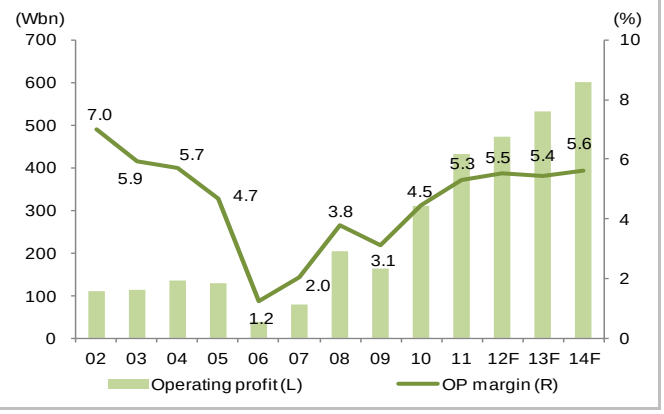
Source: Hyundai Hysco

Exhibit 10. Revenue and Growth trend



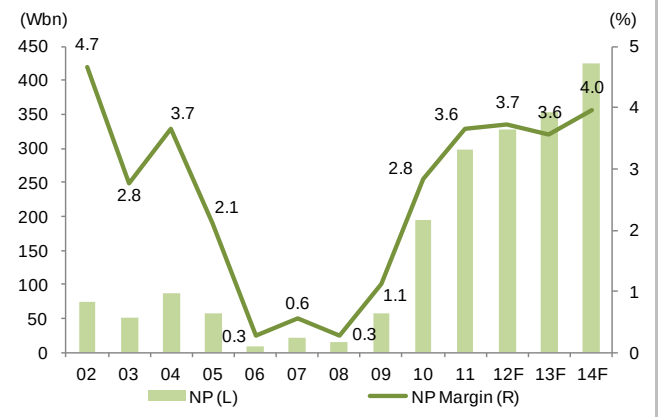
Source: Hyundai Hysco, Leading Research Center

Exhibit 11. Operating profit and OPM trend



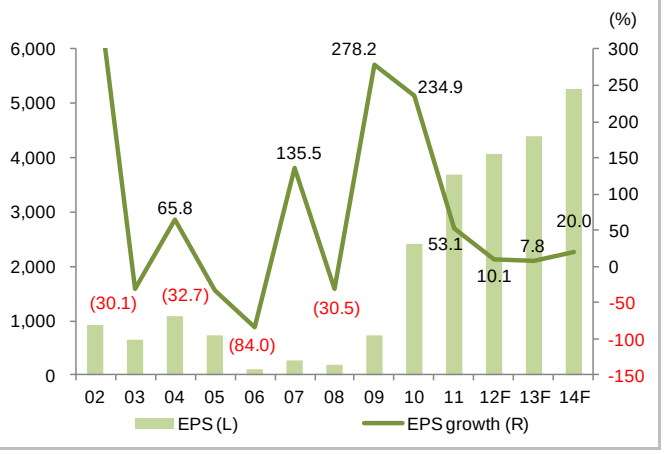
Source: Hyundai Hysco, Leading Research Center

Exhibit 12. Net profit and NP margin trend



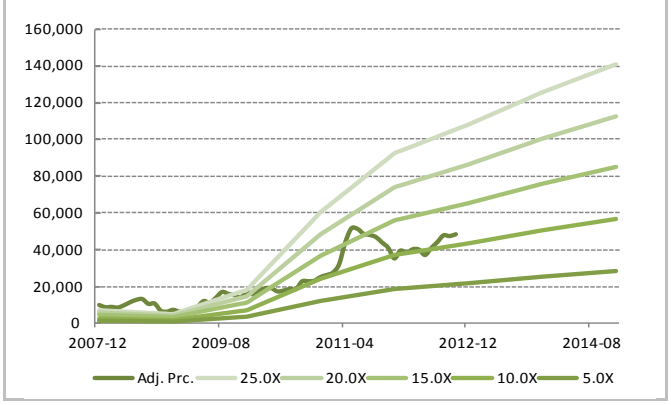
Source: Hyundai Hysco, Leading Research Center

Exhibit 13. EPS and EPS growth



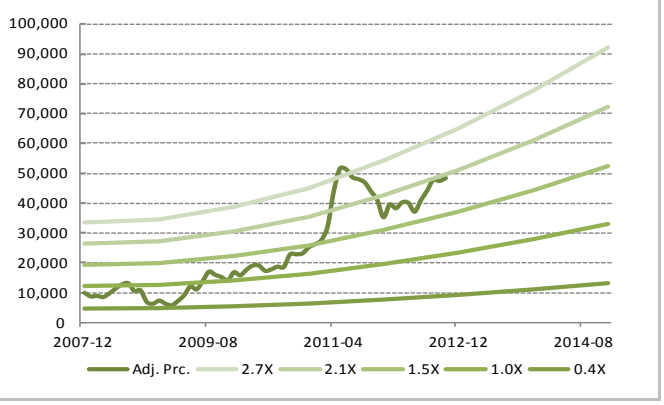
Source: Hyundai Hysco, Leading Research Center

Exhibit 14. PER Band



Source: FnGuide, Leading Research Center

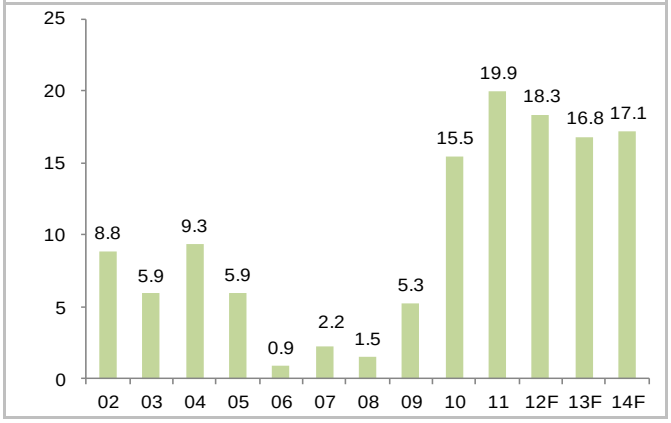
Exhibit 15. PBR Band



Source: FnGuide, Leading Research Center

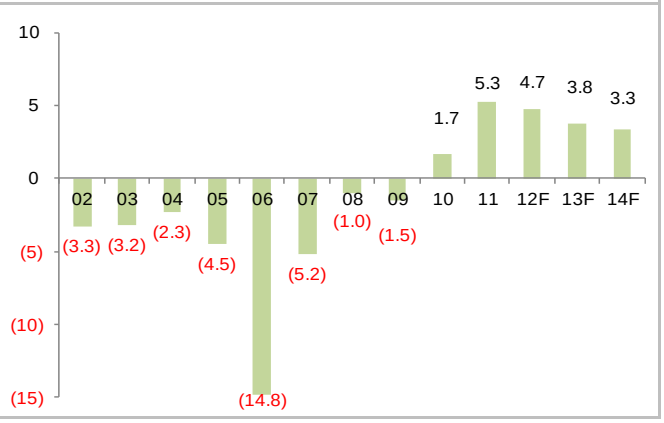
Section 3: Is the company a value creator?

Exhibit 16. ROE (%)



Source: Hyundai Hysco, Leading Research Center

Exhibit 17. EVA: ROIC less WACC (%)



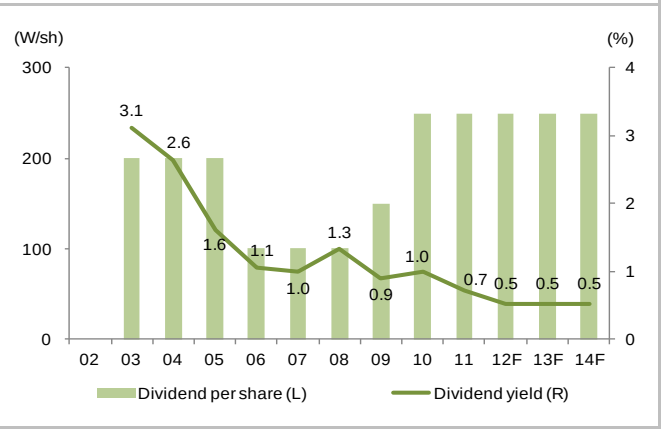
Source: Hyundai Hysco, Leading Research Center

Section 4: Free cashflow generation and dividend policy

Exhibit 18. Free Cash Flow trend (Wbn)

Source: Hyundai Hysco, Leading Research Center

Exhibit 19. Dividend per share and yield trend



Source: Hyundai Hysco, Leading Research Center

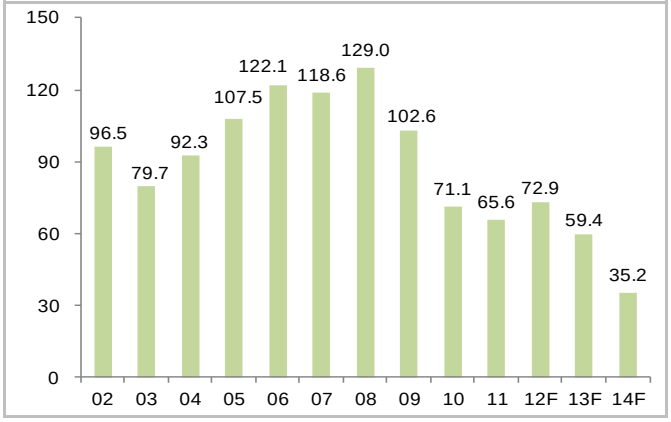
Exhibit 20. Dividends per share and dividend rate trend

(Wbn)	02	03	04	05	06	07	08	09	10	11E	12F	13F	14F
Cash from operation	118.0	181.8	103.4	178.1	153.1	140.4	3.2	64.6	490.1	567.6	434.2	400.4	530.0
CAPEX	45.1	53.2	271.7	326.4	219.8	117.8	73.3	75.0	137.4	511.7	820.0	350.0	150.0
Free cash flow	72.9	128.6	(168.2)	(148.2)	(66.8)	22.6	(70.2)	(10.4)	352.7	55.9	(385.8)	50.4	380.0
Total dividend		16.0	16.0	16.0	8.0	7.9	7.9	11.9	19.9	19.9	19.9	19.9	19.9
Dividend/shr (W/shr)		200	200	200	100	100	100	150	250	250	250	250	250
Dividend yield(%)		3.1	2.6	1.6	1.1	1.0	1.3	0.9	1.0	0.7	0.5	0.5	0.5

Note: Dividend yield on last price of the year
Source: Hyundai Hysco, Leading Research Center

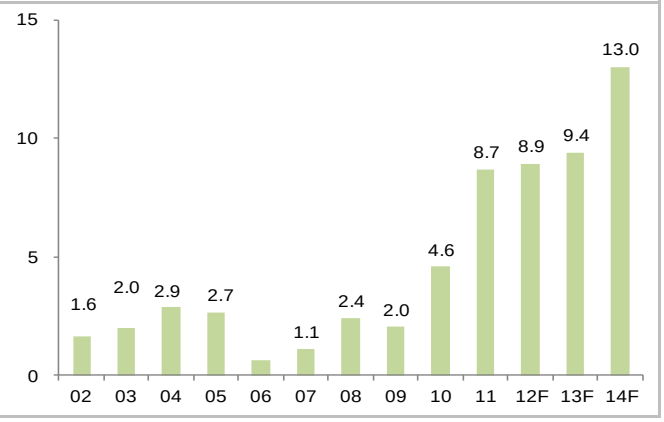
Section 5: Are the debt and interest burden manageable?

Exhibit 21. Net debt/equity ratio (%)



Source: Hyundai Hysco, Leading Research Center

Exhibit 22. Interest coverage (X)



Source: Hyundai Hysco, Leading Research Center

Exhibit 23. Interest bearing debt and interest coverage trend

(Wbn)	02	03	04	05	06	07	08	09	10	11F	12F	13F	14F
Interest bear debt	902	777	925	1,120	1,266	1,299	1,636	1,516	1,406	1,519	1,654	1,727	1,599
Cash & equivalents	66	62	41	44	53	106	298	320	445	448	239	376	655
Net int bearing debt	836	715	883	1,075	1,213	1,193	1,338	1,196	961	1,072	1,416	1,351	944
Net debt/equity (%)	96.5	79.7	92.3	107.5	122.1	118.6	129.0	102.6	71.1	65.6	72.9	59.4	35.2
Net interest	69	57	47	49	64	73	85	80	67	50	55	57	47
Interest coverage (x)	1.6	2.0	2.9	2.7	0.6	1.1	2.4	2.0	4.6	8.7	8.9	9.4	13.0

Source: Hyundai Hysco, Leading Research Center

Section 6: FX exposure and sensitivities

Exhibit 24. FX sensitivity 2012E (Non-consolidated)

Currency rate change	-5%	-1%	Base	1%	5%
Year-avg (KRW/US$)	1,078	1,124	1,135	1,146	1,192
Revenue (Wbn)	7,398.2	7,476.8	7,496.5	7,516.1	7,594.7
Operating profit (Wbn)	353.7	393.2	403.0	412.9	452.4
NP (Wbn)	281.2	305.8	311.9	318.1	342.7
EPS(W)	3,506	3,812	3,889	3,966	4,272
PER	13.7	12.6	12.4	12.2	11.3
Revenue change (%)	(1.3)	(0.3)		0.3	1.3
OPM (%)	(12.2)	(2.4)		2.4	12.2
NP (%)	(9.9)	(2.0)		2.0	9.9
EPS change (%)	(9.9)	(2.0)		2.0	9.9

Source: Hyundai Hysco, Leading Research Center

Exhibit 25. FX sensitivity 2013E (Non-consolidated)

Currency rate change	-5%	-1%	Base	1%	5%
Year-avg (KRW/US$)	1,054	1,098	1,109	1,120	1,164
Revenue (Wbn)	8,269.3	8,377.2	8,404.2	8,431.2	8,539.1
Operating profit (Wbn)	369.3	428.2	442.9	457.6	516.4
NP (Wbn)	291.6	320.4	327.6	334.8	363.6
EPS(W)	3,636	3,995	4,085	4,175	4,534
PER	13.3	12.1	11.8	11.5	10.6
Revenue change (%)	(1.6)	(0.3)		0.3	1.6
OPM (%)	(16.6)	(3.3)		3.3	16.6
NP (%)	(11.0)	(2.2)		2.2	11.0
EPS change (%)	(11.0)	(2.2)		2.2	11.0

Source: Hyundai Hysco, Leading Research Center

Exhibit 26. FX sensitivity 2014E (Non-consolidated)

Currency rate change	-5%	-1%	Base	1%	5%
Year-avg (KRW/US$)	1,018	1,061	1,072	1,082	1,125
Revenue (Wbn)	8,884.8	9,013.3	9,045.5	9,077.6	9,206.1
Operating profit (Wbn)	400.5	476.3	495.3	514.2	590.0
NP (Wbn)	318.9	372.3	385.7	399.0	452.4
EPS(W)	3,977	4,642	4,809	4,975	5,641
PER	12.1	10.4	10.0	9.7	8.5
Revenue change (%)	(1.8)	(0.4)		0.4	1.8
OPM (%)	(19.1)	(3.8)		3.8	19.1
NP (%)	(17.3)	(3.5)		3.5	17.3
EPS change (%)	(17.3)	(3.5)		3.5	17.3

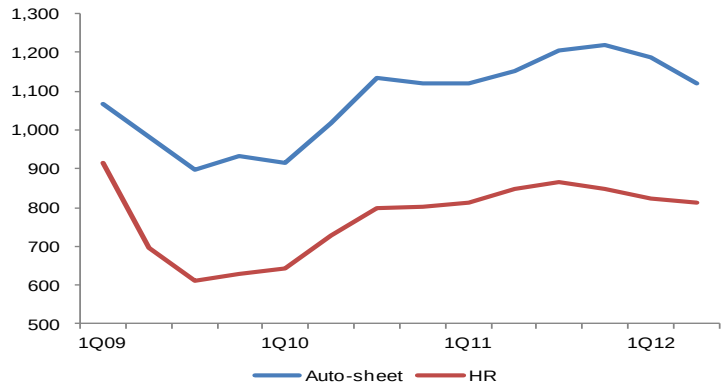
Source: Hyundai Hysco, Leading Research Center

Section 7: Operations overview

Maintaining stable profitability given relatively stable supply and demand in the CR automotive market

Hyundai Hysco maintains OPM at the 5~6% range regardless of fluctuation of steel price unlike blast furnace mills. Despite decline in steel price, Hyundai Hysco's profitability does not heavily fluctuate because of stable price spread between CRC and HRC. Decline in HRC (raw material) price is offset decrease in CRC price. Stable spread comes from difference between supply and demand in raw material and product markets rather than Hyundai Hysco's reinforcement of price bargaining power.

Exhibit 27. Price spread between CRC & HRC (Thousand Won/ton)



Source: Hyundai Hysco, Leading Research Center

CR companies are dominant in price bargaining power terms due to supply surplus

In the HR market, the raw material market, supply volume largely increased given market entry of Hyundai Steel as well as capacity addition of Chinese companies. As a result, second rolling companies predominated on price bargaining power. Hyundai Hysco purchased HRC for pipe in 2Q12 and received a discount from POSCO and Hyundai Steel. Therefore, OPM of the pipe unit increased to 5.7% from 0.3% in the previous quarter. This implies supply surplus in the HR market. On the other hand, supply and demand of Auto-steel is tight. However, automakers predominate on price bargaining power in the CR market.

Exhibit 28. HR steel sheet supply & demand trend

(10k ton)	2008	2009	2010	2011	2012E	2013E	2014E
Domestic	3,048	2,500	3,184	3,252	3,309	3,414	3,551
Export	363	418	472	644	658	679	708
Total demand	3,412	2,918	3,656	3,897	3,966	4,094	4,259
Production	2,659	2,338	2,941	3,365	3,492	3,629	3,783
Import	752	579	715	531	474	465	476
Capacity	3,181	3,431	3,481	3,831	3,831	3,831	3,831
Capacity/domestic (%)	104.3	137.3	109.3	117.8	115.8	112.2	107.9
Operation rate (%)	83.6	68.2	84.5	87.8	91.2	94.7	98.7

Source: Korea Iron & Steel Association, POSRI, Leading Research Center

Raw material suppliers such as POSCO and Hyundai Steel will be burdened by effect from CR price decrease in 4Q

Hyundai/Kia Motors accepted relatively high CR price by 3Q, but strongly demands cut in supply price in 4Q. Hyundai/Kia Motors demands price reduction of 6% in 4Q (W70,000/ton), and POSCO also suggests price reduction of 3% (W30,000/ton). However, CR price cut will affect POSCO and Hyundai Steel which produce HRC. CR spread of Hyundai Hysco will be similar to the level in 3Q

Exhibit 29. Hyundai Hysco capacity trend by CR product

(10k ton)	2008	2009	2010	2011	2012E	2013E	2014E
GI	1,440	1,440	1,440	1,590	1,990	2,490	2,490
CR	1,000	1,000	1,000	1,050	1,150	2,150	2,150
PO	340	340	340	340	340	340	340
HGI	300	300	300	300	300	300	300
EG	450	450	450	450	450	450	450
CC	270	270	270	270	270	270	270
Total	**3,800**	**3,800**	**3,800**	**4,000**	**4,500**	**6,000**	**6,000**
Automotive steel	2,550	2,550	2,550	2,750	3,250	4,750	4,750
General steel	1,250	1,250	1,250	1,250	1,250	1,250	1,250

Source: Hyundai Hysco, Leading Research Center

Automotive steel capacity will increase to 46% with Dangjin No.2 CR plant

1m tons of 1.5m tons in Dangjin No.2 CR plant capacity is for a CR production line and 0.5m tons is for a GI production line. However, it is difficult to classify automotive steel and general CR production by plant capacity per product. GI and CC, which are hard to use for auto, are clearly classified by a general CR facility. However, other facilities are able to cross produce automotive steels and general CRs. Hyundai Hysco plans to produce automotive steel in 1.5m tons Dangjin No.2 CR plant for a while. As a result, real automotive steel capacity will be likely increase to 4.75 tons.

Expecting supply share of steel sheet to Hyundai/Kia Motor of 55% maximally

Some people expect that most steel sheets, which will be produced in Dangjin No.2 CR plant, will be supplied to Hyundai/Kia Motors' overseas plants, and Hyundai Hysco's share of steel sheet supply to Hyundai/Kia Motors will increase to 70% from 54%. However, it seems overestimation to emphasis growth given captive demand. In consideration of automakers' practice to diversify supply lines for raw materials and parts, Hyundai Hysco's share of steel sheet supply will be unlikely to exceed 70%. We estimate supply share of 55% in 2014 when Dangjin No.2 CR plant will fully operate with increase in supply to overseas plants, while share of steel sheet supply to domestic Hyundai/Kia Motors plants will be flat.

Hysco should sell over 40% of output which produced in Danjin No.2 plant to non-Hyundai automakers

On the assumption that Hyundai Hysco's share of steel sheet supply to Hyundai/Kia Motors is 55%, Hyundai Hysco should sell steel sheets of 920,000 tons to domestic/overseas automakers besides Hyundai/Kia Motors in 2014 (300,000 tons in 2013). Increase of 620,000 tons corresponds to 41% of additional capacity. Securing sales sources might be possible given tight supply and demand of automotive steels. However, we believe that this is a risk factor unlike the market expectations that the company is able to sell 1.5m tons additional output to Hyundai/Kia Motors.

Planning to expand steel sheet sales to Chinese local automakers

Hyundai Hysco considers Chinese local automakers as potential customers rather than Korean non-Hyundai/Kia automakers. While total annual steel sheet quantity of demand of non-Hyundai/Kia automakers, GM Korea, Renault Samsung, and Ssangyong, is estimated at 1m tons (0.18m tons by Hysco), Hyundai Hysco does not plan to expand its sales to those companies. Even though Hyundai Hysco secures additional sales, the volume will be limited under share competition with POSCO in the domestic market. Moreover, disadvantages to Hyundai Hysco will be larger than POSCO's.

We believe that the quantity of merchandise auto-sheet, which will be substituted to own manufactured products, is important in addition to product sales which will be increased from Dangjin No.2 CR plant. If the company substitutes manufactured products for merchandise auto-sheet, profitability will be improved. Moreover, the company is expected to ease market competition and the supply burden to sell to non-Hyundai/Kia automakers.

Exhibit 30. Hyundai Hysco's CR sales trend to Hyundai/Kia Motors

	2010	2011	2012E	2013E	2014E
Hyundai/Kia Motors auto sales ('000 unit)	**5,762**	**6,608**	**7,107**	**7,499**	**7,751**
Domestic plant	3,131	3,466	3,587	3,676	3,762
Overseas plant	2,631	3,142	3,519	3,823	3,989
Hyundai/Kia Motors steel sheet demand ('000 tons)	**5,186**	**5,947**	**6,396**	**6,749**	**6,976**
Domestic plant	3,344	3,748	3,932	4,073	4,183
Overseas plant	1,842	2,200	2,464	2,676	2,793
Hysco CR steel sheet sales ('000 tons)	**4,305**	**4,614**	**4,988**	**5,628**	**6,203**
Manufactured product	3,783	4,030	4,488	5,228	5,903
Merchandise	522	584	500	400	300
Nominal automotive steel sales ('000 tons)	**2,784**	**3,201**	**3,558**	**3,928**	**4,139**
Domestic	2,124	2,364	2,481	2,569	2,639
Export	660	837	1,078	1,359	1,500
Nominal general CR sales ('000 tons)	**1,521**	**1,413**	**1,430**	**1,700**	**2,064**
Automotive	290	300	307	513	915
Real automotive steel sales ('000 tons)	**3,074**	**3,501**	**3,865**	**4,441**	**5,054**
Manufactured product	2,552	2,917	3,365	4,041	4,754
Merchandise	522	584	500	400	300
Hysco's total CR supply to Hyundai/Kia Motors ('000 tons)	**2,784**	**3,201**	**3,558**	**3,928**	**4,139**
Domestic plant	2,124	2,364	2,481	2,569	2,639
Overseas plant	660	837	1,078	1,359	1,500
Hysco's manufactured product CR supply to Hyundai/Kia Motors ('000 tons)	**2,262**	**2,617**	**3,058**	**3,528**	**3,839**
Domestic plant	2,124	2,364	2,481	2,569	2,639
Overseas plant	138	253	578	959	1,200
Hysco's total CR supply share to Hyundai/Kia Motors (%)	**53.7**	**53.8**	**55.6**	**58.2**	**59.3**
Domestic plant	63.5	63.1	63.1	63.1	63.1
Overseas plant	35.8	38.1	43.7	50.8	53.7
Hysco's manufactured product CR supply share to Hyundai/Kia Motors (%)	**43.6**	**44.0**	**47.8**	**52.3**	**55.0**
Domestic plant	63.5	63.1	63.1	63.1	63.1
Overseas plant	7.5	11.5	23.4	35.8	43.0
Total steel sheet sales to other automakers ('000 tons)	**290**	**300**	**307**	**513**	**915**
Domestic	174	180	182	188	196
Overseas	116	120	125	325	719

Note: 1. Since Hyundai Hysco classifies steel sheet sales to other automakers as general CR sales, we reclassiffies it as real automotive steel sales

2. Estimation based on the company's guidance except Hyundai/Kia Motors' auto sales and Hysco's nominal sales in 2010 and 2011

Source: Hyundai Hysco, Hyundai/Kia Motors, Leading Research Center

Section 8: Earnings forecast

Decrease in revenue is estimated in 3Q from 2Q due to the seasonal effect, but margin will be stable

In 3Q12, Hyundai Hysco's revenue will be likely to decline from 2Q due to seasonal effects and Hyundai/Kia Motors' domestic plant strike. Non-consolidated OPM is estimated to slightly decline given fixed costs due to decrease in margin and revenue from the pipe unit. While profitability of CR steel sheet, the flagship product, will be likely to be flat in 3Q, the low material effect on the pipe will gradually diminish. Consolidated OPM will be similar to the level in 2Q given decline in loss on foreign exchange of overseas branches. NPM before tax will slightly increase for the reason. Non-consolidated NP before tax is expected to sharply decrease without dividend income unlike 2Q (W17.2bn from Chinese branch).

Exhibit 31. Quarterly earnings forecast

(Wbn)	1Q11	2Q11	3Q11	4Q11	1Q12	2Q12	3Q12E	4Q12E
Consolidated								
Revenue	1,856.5	2,085.0	2,044.5	2,184.4	2,108.4	2,224.2	2,127.2	2,368.6
Operating profit	106.6	122.6	96.4	109.5	115.4	122.9	117.4	131.9
CR steel sheet	94.0	105.4	87.8	95.0	113.9	105.4	104.1	118.2
Pipe	12.6	17.2	8.6	14.5	1.5	17.5	13.3	13.7
Pre-tax income	99.8	118.9	89.6	73.5	113.6	94.5	95.5	114.6
NP	73.3	93.0	71.5	59.9	94.1	70.6	75.0	88.4
Margin (%)								
Operating profit	5.7	5.9	4.7	5.0	5.5	5.5	5.5	5.6
CR steel sheet	5.9	5.9	5.0	5.0	6.2	5.5	5.6	5.7
Pipe	5.0	6.0	3.2	5.0	0.6	5.6	4.9	4.7
Pre-tax income	5.4	5.7	4.4	3.4	5.4	4.3	4.5	4.8
NP	4.0	4.5	3.5	2.7	4.5	3.2	3.5	3.7
Non-consolidated								
Revenue	1,556.7	1,771.8	1,738.6	1,868.2	1,758.0	1,921.1	1,798.1	2,019.3
Operating profit	75.9	104.8	70.1	94.9	89.8	106.2	96.2	110.8
CR steel sheet	59.0	88.9	61.4	87.0	88.6	83.1	79.2	92.8
Pipe	17.0	15.9	8.7	7.9	1.1	23.2	17.0	18.0
Pre-tax income	71.0	102.2	67.2	78.7	87.0	116.7	85.0	101.8
NP	56.9	80.1	54.9	63.6	72.8	91.2	68.0	79.9
Margin (%)								
Operating profit	4.9	5.9	4.0	5.1	5.1	5.5	5.3	5.5
CR steel sheet	4.7	6.2	4.4	5.8	6.3	5.5	5.5	5.7
Pipe	5.6	4.6	2.5	2.2	0.3	5.7	4.8	4.7
Pre-tax income	4.6	5.8	3.9	4.2	5.0	6.1	4.7	5.0
NP	3.7	4.5	3.2	3.4	4.1	4.7	3.8	4.0

Source: Hyundai Hysco, Leading Research Center

Little impact from decline in CR steel sheet price in 4Q
Margin is expected to slightly increase

In 4Q12, revenue is expected to increase over 10% from 3Q driven by increase in work day as well as Hyundai/Kia Motors' work day increase in order to recover production damage due to the strike. This is the largest revenue for the year. Hyundai/Kia Motors' demand to cut CR price is a negative factor to Hyundai Hysco's profitability, but impact of decline in HR price will be not huge on the company. Profitability is expected to slightly increase thanks to decline in fixed costs driven by revenue increase.

Profitability will be stay at the current level in 2013 and 2014 due to slump in the steel market

Hyundai Hysco is estimated to record consolidated revenue of W8.8tr (8.1% yoy) and OP of W487.7bn (12.1% yoy) in 2012. In 2013 and 2014, revenue is expected to increase along with additional output from Dangjin No.2 CR plant. Profitability will slightly decrease in 2013 from 2012 and then gradually increase in 2014 because the steel market seems unlikely to meaningfully improve in the short term.

Exhibit 32. Annual earnings forecast

(Wbn)	2008	2009	2010	2011	2012E	2013E	2014E
Consolidated							
Revenue	5,411.5	5,238.0	6,865.8	8,170.3	8,828.3	9,955.4	10,747.6
OP	204.4	162.8	306.9	435.1	487.7	539.8	606.1
Pre-tax income	19.6	74.9	250.8	381.7	418.3	452.9	544.6
NP	15.5	58.3	194.7	297.8	328.0	354.1	424.9
Margin (%)							
OP	3.8	3.1	4.5	5.3	5.5	5.4	5.6
Pre-tax income	0.4	1.4	3.7	4.7	4.7	4.5	5.1
NP	0.3	1.1	2.8	3.6	3.7	3.6	4.0
Non-consolidated							
Revenue	5,034.6	4,423.3	5,846.5	6,935.3	7,496.5	8,404.2	9,045.5
OP	171.6	142.7	235.7	345.8	403.0	442.9	495.3
Pre-tax income	26.8	68.9	189.0	319.1	390.5	414.8	488.0
NP	22.9	54.4	146.5	255.4	311.9	327.6	385.7
Margin (%)							
OP	3.4	3.2	4.0	5.0	5.4	5.3	5.5
Pre-tax income	0.5	1.6	3.2	4.6	5.2	4.9	5.4
NP	0.5	1.2	2.5	3.7	4.2	3.9	4.3

Source: Hyundai Hysco, Leading Research Center

Financial Statement

Income Statement

(Wbn)	03	04	05	06	07	08	09	10	11	12F	13F	14F
Revenue	**1,887**	**2,365**	**2,775**	**3,227**	**3,919**	**5,411**	**5,238**	**6,866**	**8,170**	**8,828**	**9,955**	**10,748**
% chg yoy	18.4	25.4	17.3	16.3	21.4	38.1	(3.2)	31.1	19.0	8.1	12.8	8.0
COGS	1,682	2,116	2,516	3,017	3,623	4,957	4,872	6,307	7,461	8,021	9,056	9,743
Gross profit	**204**	**249**	**258**	**210**	**296**	**455**	**366**	**559**	**709**	**807**	**900**	**1,005**
GP margin (%)	10.8	10.5	9.3	6.5	7.5	8.4	7.0	8.1	8.7	9.1	9.0	9.4
SG&A	93	114	128	170	216	250	204	248	276	333	367	404
Operating income	**112**	**135**	**130**	**40**	**80**	**204**	**163**	**310**	**433**	**474**	**533**	**601**
OP margin (%)	5.9	5.7	4.7	1.2	2.0	3.8	3.1	4.5	5.3	5.4	5.4	5.6
Net other income	0	0	0	0	0	0	0	(4)	2	14	7	5
Reported OP	**112**	**135**	**130**	**40**	**80**	**204**	**163**	**307**	**435**	**488**	**540**	**606**
Net other income	5.9	5.7	4.7	1.2	2.0	3.8	3.1	4.5	5.3	5.5	5.4	5.6
Financial income	27	54	24	43	32	120	110	40	61	59	43	50
Financial expenses	72	79	74	80	103	305	198	96	114	128	130	112
Income before tax	**67**	**111**	**80**	**2**	**9**	**20**	**75**	**251**	**382**	**418**	**453**	**545**
Income tax	15	24	21	(7)	(14)	4	17	56	84	90	99	120
Tax rate (%)	22.1	22.0	27.0	(382.7)	(160.8)	20.8	22.3	22.4	22.0	21.6	21.8	22.0
Net profit	**52**	**86**	**58**	**9**	**22**	**16**	**58**	**195**	**298**	**328**	**354**	**425**
Controlling	52	86	58	9	22	16	58	194	297	327	352	423
Non-controlling	0	0	0	0	0	0	0	1	1	1	2	2

Balance sheet

(Wbn)	03	04	05	06	07	08	09	10	11	12F	13F	14F
Current assets	**457**	**598**	**854**	**1,011**	**1,110**	**1,775**	**1,687**	**2,262**	**2,726**	**2,643**	**3,112**	**3,631**
Cash & equivalents	36	26	43	53	84	266	313	442	447	239	376	655
ST financial assets	26	15	1	0	23	32	7	3	0	0	0	0
Accounts receivables	250	302	408	445	484	627	758	864	1,037	1,139	1,294	1,419
Inventory	136	249	394	505	504	814	588	916	1,190	1,211	1,386	1,500
Others	8	5	7	9	17	36	21	37	52	54	57	57
Non-current assets	**1,512**	**1,607**	**1,795**	**1,926**	**1,879**	**1,831**	**1,795**	**1,711**	**1,994**	**2,615**	2,775	2,707
Fixed assets	1,423	1,578	1,752	1,832	1,792	1,700	1,692	1,597	1,843	2,443	2,593	2,513
LT financial assets	11	5	2	2	3	29	47	56	85	94	99	104
Inv in affiliates	6	0	5	3	1	14	0	0	0	0	0	0
Deferred tax asset	0	0	0	0	0	0	0	0	3	7	9	10
Others	72	25	37	89	84	87	56	57	64	71	75	80
Total assets	**1,969**	**2,205**	**2,650**	**2,936**	**2,989**	**3,606**	**3,481**	**3,973**	**4,721**	**5,258**	**5,888**	**6,338**
Current liabilities	**694**	**755**	**1,014**	**1,374**	**1,116**	**1,767**	**1,585**	**1,904**	**2,565**	**2,498**	**2,767**	**2,806**
Accounts payables	207	206	409	434	444	747	619	943	1,193	1,243	1,422	1,539
ST financial liabilities	425	438	493	712	453	848	804	722	1,031	874	925	799
Others	63	111	112	227	219	172	162	239	340	381	421	468
Non-current liabilities	**377**	**493**	**635**	**568**	**867**	**801**	**730**	**716**	**522**	**818**	**845**	**851**
LT payables	0	0	0	0	0	0	0	0	0	0	0	0
LT financial liabilities	352	487	626	554	847	788	711	685	488	780	803	800
Others	25	6	9	14	21	13	19	31	34	38	43	51
Total liabilities	**1,072**	**1,248**	**1,650**	**1,942**	**1,983**	**2,568**	**2,316**	**2,620**	**3,087**	**3,316**	**3,612**	**3,658**
Paid-in capital	447	401	401	401	401	401	401	401	401	401	401	401
Capital surplus	352	402	402	402	402	402	402	269	269	269	269	269
Others	4	(3)	(3)	(3)	(5)	18	96	(10)	(9)	(9)	(9)	(9)
Retained earnings	94	157	200	193	207	215	264	690	967	1,274	1,606	2,009
Non-controlling interest	0	0	0	1	1	2	2	3	6	7	8	10
Total shareholder equity	**897**	**957**	**1,000**	**994**	**1,006**	**1,038**	**1,166**	**1,353**	**1,634**	**1,942**	**2,276**	**2,680**

Free cashflow analysis

(Wbn)	03	04	05	06	07	08	09	10	11	12F	13F	14F
Net profit	**52**	**86**	**58**	**9**	**22**	**16**	**58**	**195**	**298**	**328**	**354**	**425**
Adj. for non-cash exp.	**119**	**157**	**138**	**153**	**180**	**314**	**149**	**374**	**422**	**167**	**168**	**249**
Depreciation	80	108	116	138	154	164	162	211	250	220	200	230
Provision for reserves	6	10	5	8	8	9	7	19	12	13	14	15
Net FX gains	(11)	(18)	3	(10)	(12)	(11)	(13)	(19)	(38)	(18)	(28)	(45)
Net eq method gains	(0)	0	(1)	0	0	(0)	0	0	0	0	0	0
Others	11	(20)	13	(7)	1	124	(37)	120	121	86	75	42
Chg in op assets & liab	**10**	**(140)**	**(18)**	**(9)**	**(61)**	**(326)**	**(143)**	**(78)**	**(153)**	**(60)**	**(122)**	**(144)**
Incr in WC (decr)	(27)	164	49	122	28	151	33	110	197	73	151	122
Others	17	(24)	(30)	(113)	33	175	110	(32)	(44)	13	29	(23)
Cash from operations	**182**	**103**	**178**	**153**	**140**	**3**	**65**	**490**	**568**	**434**	**400**	**530**
Capital expenditures	53	272	326	220	118	73	75	137	512	820	350	150
Free cash flow	**129**	**(168)**	**(148)**	**(67)**	**23**	**(70)**	**(10)**	**353**	**56**	**(386)**	**50**	**380**
Dividend	0	16	16	16	8	8	8	12	20	20	20	20
Share issues	0	0	0	0	0	0	0	0	0	0	0	0
Increase in debt	(125)	148	195	146	34	336	(120)	(109)	113	135	73	(128)
Others	(7)	(7)	30	56	15	69	(157)	106	147	(59)	(37)	(59)
Net cash flow	**33**	**(10)**	**17**	**9**	**31**	**183**	**47**	**129**	**5**	**(209)**	**137**	**279**
Beginning cash	4	36	26	43	53	84	266	313	442	447	239	376
Ending cash	36	26	43	53	84	266	313	442	447	239	376	655

Stability ratios

	03	04	05	06	07	08	09	10	11	12F	13F	14F
Current ratio	65.7	79.1	84.2	73.6	99.5	100.5	106.4	118.8	106.3	105.8	112.5	129.4
Quick ratio	8.0	4.4	5.1	5.2	7.5	15.0	18.6	19.5	16.4	9.0	12.1	18.0
Inv. holding period (d)	28.1	33.2	46.6	54.4	50.8	48.5	52.5	43.5	51.5	54.6	52.3	54.1
A/R collection period (d)	51.3	42.7	46.8	48.3	43.2	37.5	48.3	43.1	42.5	45.0	44.6	46.1
A/P period (days)	43.2	33.8	42.2	49.2	44.3	41.3	53.7	43.0	50.4	55.3	52.7	54.8
Interest bear debt (Wbn)	777	925	1,120	1,266	1,299	1,636	1,516	1,406	1,519	1,654	1,727	1,599
Cash/equivalents (Wbn)	62	41	44	53	106	298	320	445	448	239	376	655
Net int. bear debt (Wbn)	715	883	1,075	1,213	1,193	1,338	1,196	961	1,072	1,416	1,351	944
Net debt/equity (%)	79.7	92.3	107.5	122.1	118.6	129.0	102.6	71.1	65.6	72.9	59.4	35.2
Liability/equity (%)	119.5	130.4	165.0	195.4	197.1	247.5	198.7	193.7	189.0	170.8	158.7	136.5
Interest coverage (X)	2.0	2.9	2.7	0.6	1.1	2.4	2.0	4.6	8.7	8.9	9.4	13.0

Valuations and margins

	03	04	05	06	07	08	09	10	11	12F	13F	14F
EV/EBITDA (X)	22.7	16.6	19.6	27.8	21.2	13.9	15.3	9.2	7.2	7.6	7.1	5.8
EPS (W)	651	1,079	725	116	274	191	721	2,416	3,699	4,075	4,392	5,272
EPS yoy chg (%)	(30.1)	65.8	(32.7)	(84.0)	135.5	(30.5)	278.2	234.9	53.1	10.1	7.8	20.0
PER (X)	74.1	44.7	66.4	414.0	175.8	252.7	66.8	20.0	13.0	11.8	11.0	9.1
BVPS (W)	11,182	11,936	12,469	12,383	12,530	12,913	14,506	16,828	20,300	24,127	28,271	33,295
P/BVPS (X)	4.3	4.0	3.9	3.9	3.8	3.7	3.3	2.9	2.4	2.0	1.7	1.4
Dividend/sh (W)	200	200	200	100	100	100	150	250	250	250	250	250
Dividend yield (%)	0.4	0.4	0.4	0.2	0.2	0.2	0.3	0.5	0.5	0.5	0.5	0.5
ROE (%)	5.9	9.3	5.9	0.9	2.2	1.5	5.3	15.5	19.9	18.3	16.8	17.1
ROA (%)	2.6	4.1	2.4	0.3	0.7	0.5	1.6	5.2	6.9	6.6	6.4	7.0
GP margin (%)	10.8	10.5	9.3	6.5	7.5	8.4	7.0	8.1	8.7	9.1	9.0	9.4
OP margin (%)	5.9	5.7	4.7	1.2	2.0	3.8	3.1	4.5	5.3	5.5	5.4	5.6
NP margin (%)	2.8	3.7	2.1	0.3	0.6	0.3	1.1	2.8	3.6	3.7	3.6	4.0
EBITDA margin (%)	10.7	12.1	9.1	5.7	6.1	6.9	6.3	7.7	8.4	7.9	7.4	7.8
ROIC (%)	5.3	6.1	4.8	9.0	9.5	7.1	5.3	10.3	13.5	12.3	11.9	12.9
WACC (%)	8.5	8.5	9.4	23.8	14.7	8.1	6.8	8.6	8.2	7.0	8.3	9.7
ROIC less WACC	(3.2)	(2.3)	(4.5)	(14.8)	(5.2)	(1.0)	(1.5)	1.7	5.3	5.2	3.7	3.2

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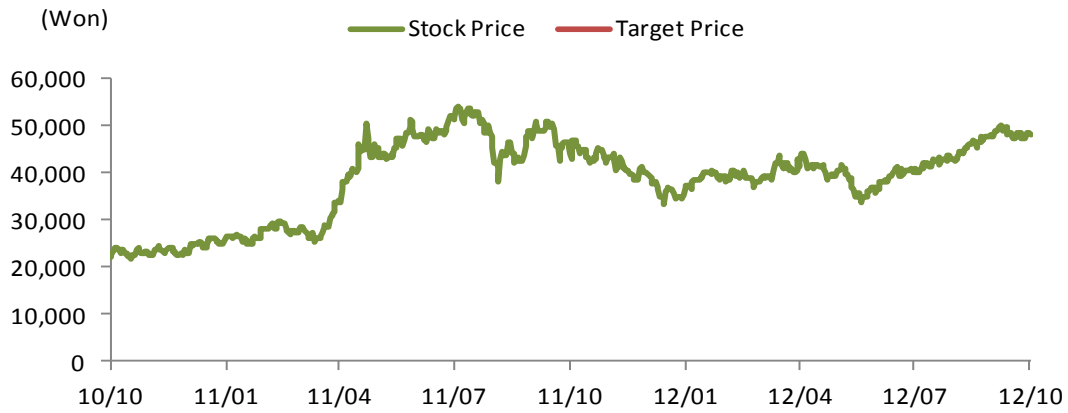
▶ Ratings and target price history in past two years

Hyundai Hysco (010520 KS)	
Date	2012-10-08
Rating	HOLD
Target price	53,000

▶ Target price changes in past two years



▶ Investment period and ratings

Company	
BUY	The stock is expected to outperform the market by at least 15%p over the next 12 months.
HOLD	The stock is expected to either outperform or underperform the market by less than 15%p over the next 12 months.
SELL	The stock is expected to underperform the market by at least 15%p over the next 12 months

Industry	
OVERWEIGHT	Industry indicators are expected to outperform the by at least 5%p over the next 12 months.
NEUTRAL	Industry indicators are expected to be in line with the market within 5%p over the next 12 months.
UNDERWEIGHT	Industry indicators are expected to underperform the market by at least 5%p over the next 12 months

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