LEADING

Mid-Cap Research

August 29, 2011

Woorim Machinery (101170 KQ)

Accelerating recovery

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Leading Traffic Light: Green

Woorim Machinery is…

- ✓ A manufacturer of excavator and industrial reducers (ER and IR)
- ✓ Largest ER supplier to Doosan Mottrol, a heavy machinery division of Doosan Corp.

Green light because:

- ✓ Strong revenue and earnings recovery in line with order increases and capacity expansion
- ✓ Excessively undervalued relative to the market and peer group companies

Growth potential:
- ➢ Revenues to increase 140% from 2010 through 2013 thanks to both increasing ER sales to Doosan Mottrol and recovery in IR orders
- ➢ Earnings growth to be in line with top line growth

Management & shareholder concern:
- ➢ Excellent management capabilities with the full knowledge of the reducer manufacturing business
- ➢ Low dividend yield at a mere 0.5%, but reasonable given heavy capital expenditures

Value creation and financial stability:
- ➢ ROEs of 13-15%, among the most profitable in the low margin machinery/parts manufacturing industry
- ➢ Net cash position despite major capital investment

Valuation:
- ➢ Excessively undervalued relative to the market and peer group companies with 2011E-2013E EV/EBITDA of 3.1-5.9x
- ➢ Target price W12,400 - a 31% upside potential

CAVEAT EMPTOR!!! – Watch out for…
- ➢ Sustainability of overseas industrial reducer orders
- ➢ Supply shortage of raw materials, especially casting metal

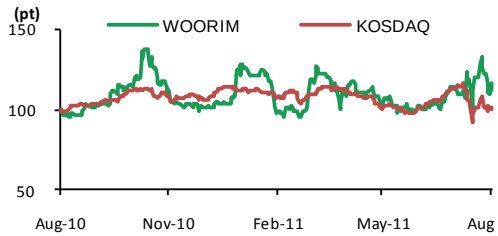
BUY

Target Price (KRW)	**12,400**
Current Price (KRW)	**9,470**
Upside potential	**30.9%**

Key Data	**August 26, 2011**
Sector	Materials
KOSDAQ	471.5
Market Cap. (Wbn)	85.2
Shares Outstanding (m)	9.0
Foreign Ownership (%)	2.9
52 Week High (W)	11,200
Low (W)	7,760
60-d avg. turnover (Wbn)	0.5
Major Shareholders	**(%)**
Kyuseok Han & others	60.8
National Pension Fund	4.1

Performance (%)	**1M**	**6M**	**12M**
Absolute	5.2	17.6	17.8
Relative	17.3	24.7	15.9

Relative Performance



Valuation Forecast

FY	Sales (Wbn)	% chg yoy	OP (Wbn)	OPM (%)	NP (Wbn)	EPS (W)	EPS Growth (%)	P/E (x)	EV/EBITDA (x)	ROE (%)	P/B (x)
2008	53.9	71.2	14.1	26.2	11.0	1,630	78.2	5.8	4.1	48.8	2.2
2009	44.2	(18.1)	10.0	22.7	8.6	955	(41.4)	9.9	5.7	20.3	1.3
2010	50.3	13.9	6.7	13.4	6.4	715	(25.2)	13.2	6.4	11.0	1.4
2011E	78.9	57.0	10.2	12.9	8.5	950	32.9	10.0	5.9	13.2	1.3
2012F	101.4	28.4	12.8	12.6	10.9	1,215	28.0	7.8	4.2	14.9	1.1
2013F	120.6	19.0	14.7	12.2	12.8	1,423	17.1	6.7	3.1	15.1	0.9

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Key check points for Woorim Machinery

✓ Strong growth momentum in line with order increases and capacity expansion

Woorim suffered sharp profit declines during 2008~2010 period mainly due to decreases in high margin industrial reducer (IR) sales. Excavator reducer (ER) sales more than doubled in 2010, but IR sales declined further. However, while ER sales growth to Doosan Mottrol, a heavy machinery parts manufacturing division of Doosan Corp. (000150 KS), are accelerating in 2011, Woorim has successfully developed overseas markets securing a huge IR order from US. We expect Woorim's revenue to increase 57% yoy to W79bn in 2011 followed by per annum growth of more than 20% yoy through 2013. Net income should also bottom out from 2010 low to increase 33% yoy to W8.5bn in 2011 and reach W12.8bn in 2013 (Page 15).

✓ Capacity expansion to respond to order increases

The construction of a new plant has been underway to be completed by October this year at a total cost of W23bn. Woorim's capacity for ER and IR will be expanded to W100bn (from W50bn) and W50bn (from W30bn), respectively, upon the completion of the new plant. Woorim will not be able to meet ER demand from Doosan Mottrol with its current capacity in the next few months as Mottrol is rapidly increasing its hydraulic components to local producers in China and the all three major domestic excavator assemblers including Doosan Infracore (042670 KS), Hyundai Heavy Ind. (009540 KS) and Volvo (unlisted). Mottrol has already requested Woorim to supply 25% more ERs beginning in 4Q11 (Page 13).

✓ Recovery in high margin industrial reducer revenue

IR is highly profitable with an operating margin of slightly above 20% compared to ER's 10%, according to the company. IR accounted for 58% of the company's total operating profit in 1H11 despite a lower revenue portion of 39%. IR revenue in 1H11 already amounted to 70% of 2010 revenue and is expected to increase almost 60% yoy to W29.4bn in 2011. New overseas order has been the largest contributor for IR revenue growth. The company received natural gas drilling reducer orders worth W7bn in 1H11 from Obatan Chicago Gear (OCG), a US based industrial equipment supplier, and plans to supply W10bn worth of reducers to OCG in 2011. Domestic demand for IRs has been on a recovery trend as well in line with capacity expansions at major steel mills and a recovery in shipbuilding orders (Page 13).

✓ Excellent financial stability

Despite continuous capacity expenditures in the past few years, Woorim still had net cash of W17bn as of end of 2010. The company's net cash should decline to below W1bn in 2011 due to the ongoing new plant construction, the biggest capacity expansion project in the company history. However, the company has no major capex plan after the completion of the new plant and we estimate the company's net cash will reach W23 in 2013 (Page 8).

✓ Target price W12,400 – a 31% upside potential

Given the capital intensive nature of the machinery/parts manufacturing business, we believe EV/EBITDA is the most appropriate valuation measure for Woorim. The company shares are excessively undervalued relative to the market and peer group companies with 2011F-2013F EV/EBITDA of only 3.1-5.9x. We have derived our target price of W12,400 by applying 2011E market EV/EBITDA of 7.7x (Page 17).

Section 1: Company at a glance

Specialized manufacturer of excavator and industrial reducers

Woorim is a specialized manufacturer of ERs and IRs. The company's ERs are supplied to major excavator assemblers such as Doosan Infracore, Hyundai Heavy Ind., Volvo and Komatsu through hydraulic components manufactures, mainly Doosan Mottrol and Nabtesco of Japan. IRs have a wider range of applications in the steel, shipbuilding, cargo handling, construction and power plant industries. Major customers for the company's IRs include POSCO (005490.KS). Hyundai Heavy Ind., STX (011810.KS), Doosan Heavy Ind. (034020.KS), Hyundai Wia (011210.KS) and other industrial equipment manufacturers.

Chart 1. Excavator reducer

Source: Company data

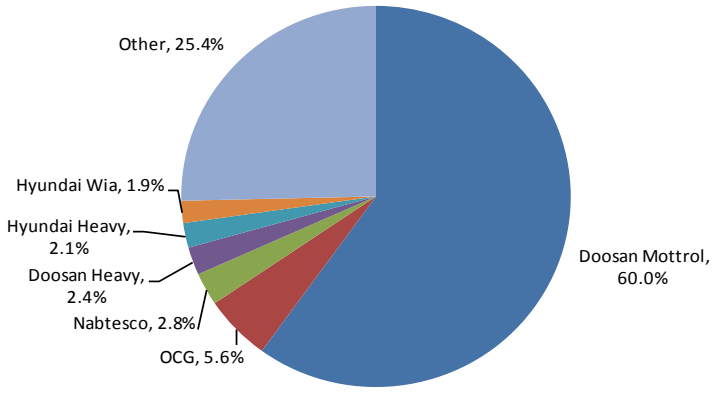
Chart 2. Industrial reducer

Source: Company data

Doosan Mottrol is the largest client

ERs are mass production items with a limited range of product portfolio. The company supplies more than 90% of its ERs to Doosan Mottrol and around 5% to Nabtesco, on an OEM basis. Mottrol is the largest client, accounting for 60% of Woorim's total revenue in 2010. IRs are custom-made products and have a diverse client base with revenue contribution from the largest client not exceeding 16% of total IR revenues. Woorim designs IRs to fit in the size and shape of equipment for each individual client. As such, IRs are more profitable than ERs whereas ER OEM clients have a strong bargaining power in price negotiations.

Chart 3. Client Breakdown in 2010

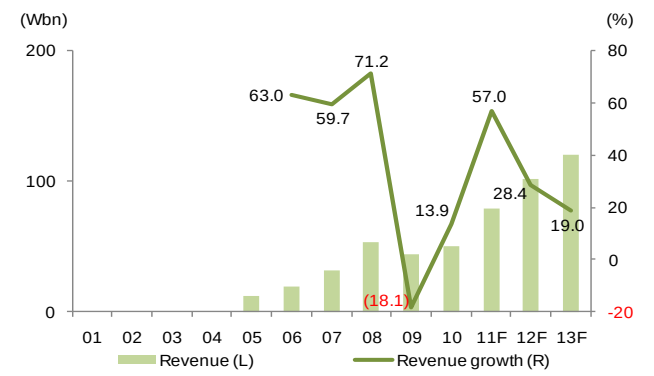


Source: Company data

High margin industrial reducers

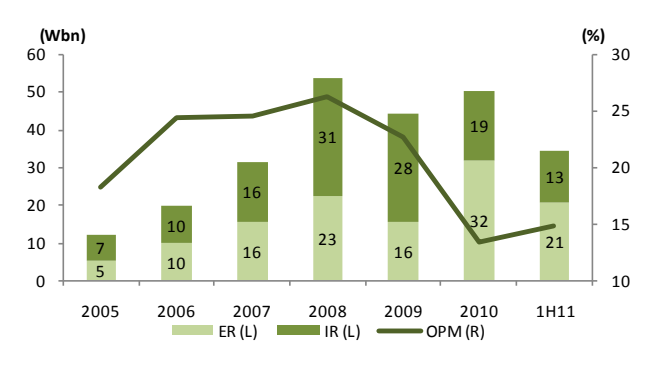
According to the company, IRs are highly profitable with an operating profit margin of slightly above 20% compared ER's 10%. Indeed, the company's operating margin jumped to as high as 26% in 2008 when IR revenue almost doubled to account for 58% of the total revenue. While the IR revenue portion rose further to 65% in 2009 and operating margin fell to 23%, profit margin contraction was attributable to sharp decline in ER revenue. Despite decline in total revenue, we believe relatively strong IR revenue supported operating margin at above 20%. Operating margin eventually fell sharply to 13% in 2010 along with sharp decline in IR revenue. However, profit margin recovered in 1H11 in line with a recovery in IR revenue and the increasing revenue portion of IRs.

Chart 4. Revenue and growth trend



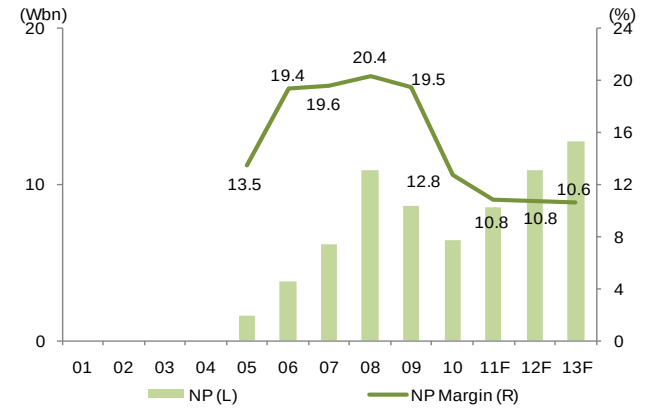
Source: Company data and Leading Research Center

Chart 5. Product mix and operating margin trend



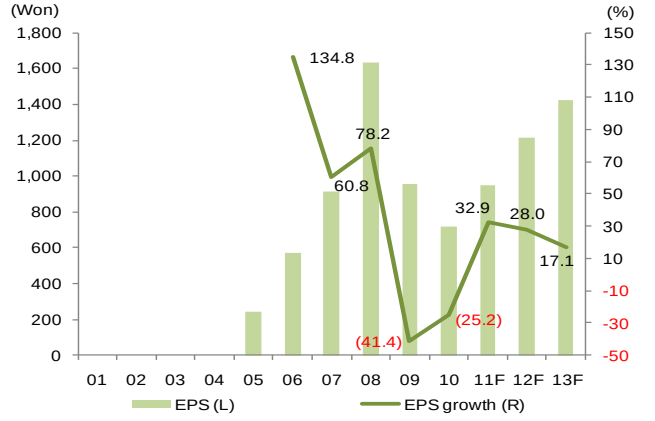
Source: Company data

Chart 6. Net income and profit margin trend



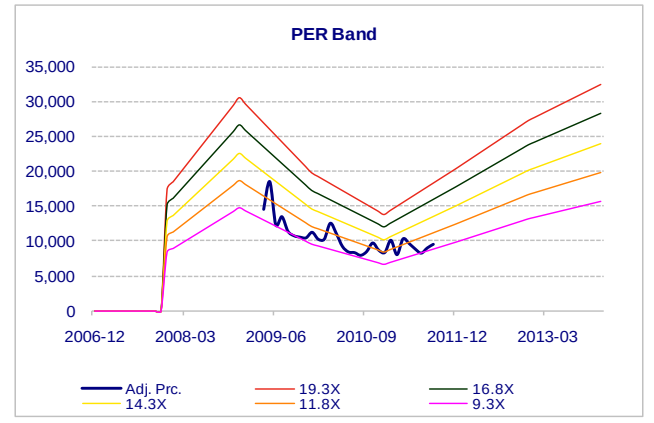
Source: Company data and Leading Research Center

Chart 7. EPS and EPS growth



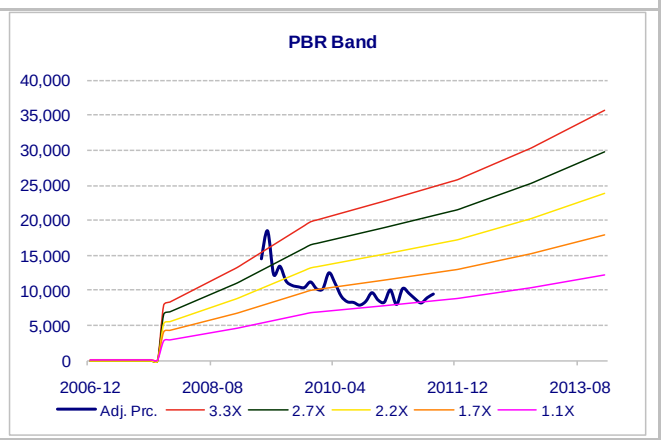
Source: Company data and Leading Research Center

Chart 8. PER Band



Source: FnGuide and Leading Research Center

Chart 9. PBR Band



Source: FnGuide and Leading Research Center

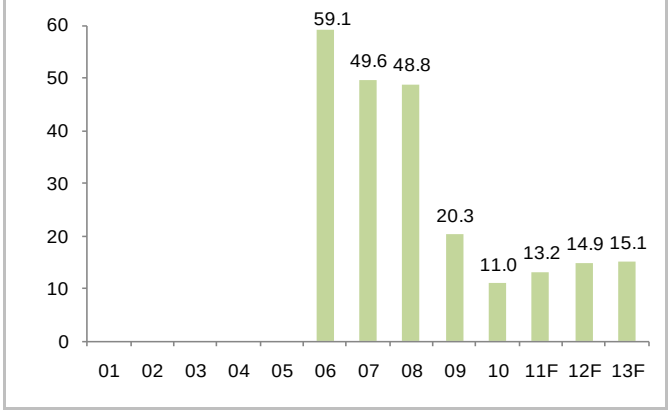
Section 2: Is the company a value creator?

ROE to recover from 2010 bottom

ROE to recover to 15% levels in 2012 and 2013 from the 2010 bottom of 11%

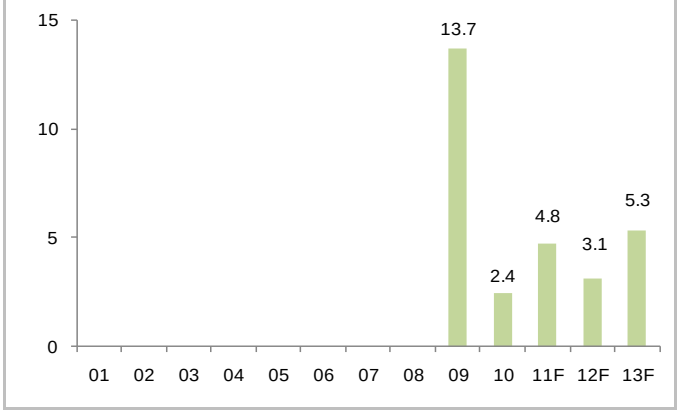
ROE fell rapidly to 11% in 2010 from 50-60% during 2006 and 2008 as the IPO increased equity base by almost 70% in 2009 and earnings continued to decline due to price competition in the IR market. However, both revenue and profit will rise more than 50% yoy in 2011 benefiting from order growth. We estimate ROE will recover from 2010 bottom to 13% in 2011 and improve further to 15% levels during 2012 and 2013. Although a 15% ROE may not be comparable to 50-60% recorded before the IPO, we believe a 15% is reasonably high among domestic manufacturing companies and among the most profitable in the low margin heavy machinery/parts industry in Korea.

Chart 10. ROE (%)



Source: Company data, Leading Research Center

Chart 11. ROIC less WACC (%)



Source: Company data, Leading Research Center

ROIC to remain only at slightly higher levels than WACC due to heavy capital investment

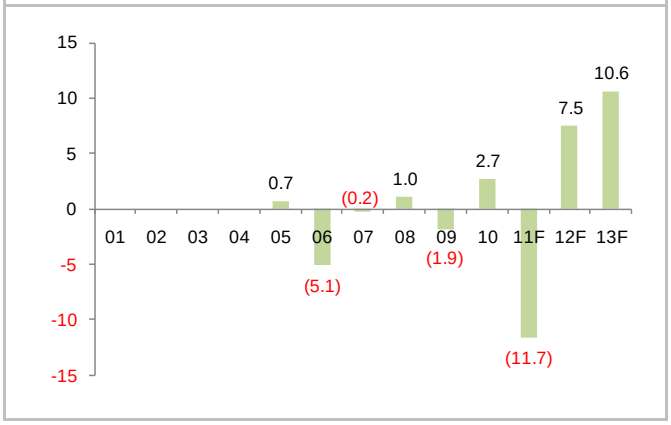
ROIC also fell to 13% in 2010 from 47% in 2008 due to the same reasons. Invested capital should increase sharply again in 2011 given the heavy capital expenditure of more than W23bn and therefore ROIC will continue to remain at slightly higher levels than WACC in the next few years.

Section 3: Is the company a cash generator and share cash with shareholders?

Free cash flow surplus in 2012 upon the completion of major capacity expansion

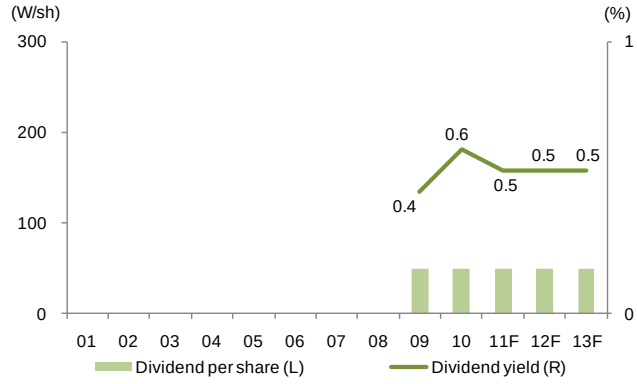
Woorim barely generated free cashflow during the past few years. Although The company generated sizable operating cashflow of W18.5bn even during the down cycle in 2009 and 2010, continuous capacity expansion investment drained of all the cashflow surplus from operation (We interpret this as an indication of the discreet management style in a sense that the management wisely limited capex only to internally generated cash flow levels without incurring debts. See page 8). We expect the company to record negative free cashflow of around W12bn this year given the capital investment of W23.5bn compared to W5.8bn in 2010. However, there will be no major capacity expansion after 2011 and we estimated the company will generate free cashflow of W7bn in 2012 and W10bn in 2013.

Chart 12. Free cashflow trend (Wbn)



Source: Company data and Leading Research Center

Chart 13. Dividend per share and yield trend



Source: Company data and Leading Research Center

Low dividend yields are reasonable

The company started paying a dividend of W50 per share beginning in 2009, but dividend yields have been quite low at below 0.6%. However, the low dividends are acceptable since the company has focused on investing in capacity expansion. While it is likely that the company will increase dividends beginning in 2012 with cash flow surplus, we conservatively assume the same per share dividend of W50 through 2013.

Table 1. Dividend and yield trend

(Wbn)	05	06	07	08	09	10	11E	12F	13F
Operating cash flow	1.1	6.3	4.9	8.3	10.0	8.5	11.8	13.5	16.6
Capital expenditure	0.5	11.4	5.1	7.2	11.8	5.8	23.5	6.0	6.0
Free cash flow	0.7	(5.1)	(0.2)	1.0	(1.9)	2.7	(11.7)	7.5	10.6
Net cash holdings	0.4	0.3	0.6	2.1	17.0	19.1	2.6	13.4	25.1
Total dividend paid					0.4	0.4	0.4	0.4	0.4
Per share dividend (Won)					50	50	50	50	50
Dividend yield (%)					0.4	0.6	0.5	0.5	0.5

Note; Dividend yields in 2009 and 2010 based on the closing prices of each fiscal year
Source: Company data and Leading Research Center

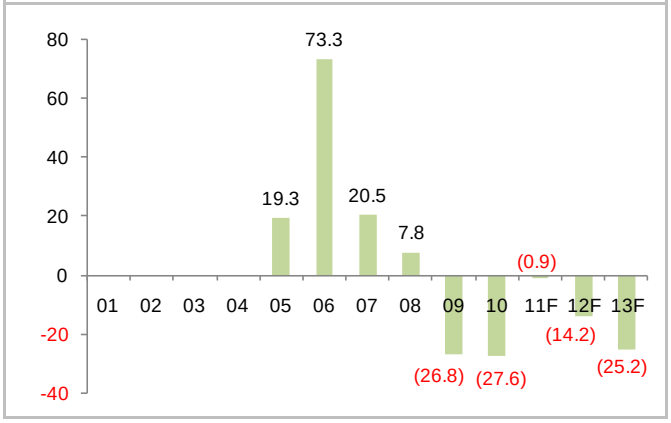
Section 4: Are the debt and interest burden manageable?

Net cash position

Net cash position despite heavy capital expenditures

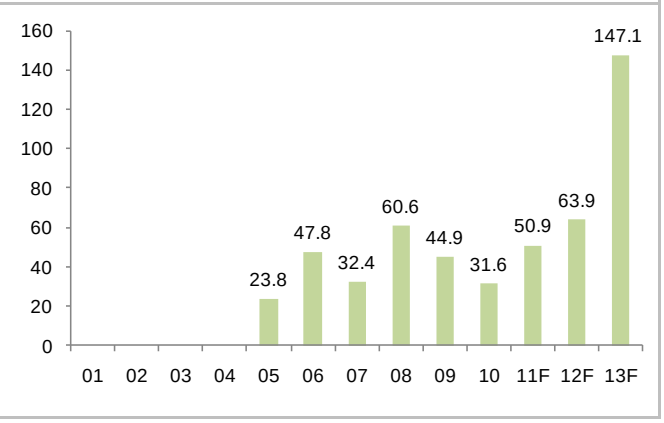
While the company generated no free cash flow during 2005 and 2010, net cash increased to W17bn in 2010. This is because the company funded all of its capital investment with operating cash flow surplus except 2006 when it incurred W5.1bn debts, and raised W19bn through the IPO in 2009. Despite the heavy capital investment in 2011, we expect the company to maintain its net cash position and its net cash to increase to W23bn in 2013.

Chart 14. Net debt/equity ratio (%)



Source: Company data and Leading Research Center

Chart 15. Interest coverage (X)



Source: Company data and Leading Research Center

Table 2. Borrowings and interest expenses

(Wbn)	2005	2006	2007	2008	2009	2010	2011F	2012F	2013F
Interest bearing debt	1.3	6.5	4.1	4.5	2.3	2.5	2.0	2.2	2.2
Cash & equivalent	0.4	0.3	0.7	2.2	17.3	19.4	2.6	13.4	25.1
Net interest bearing debt	0.9	6.1	3.4	2.2	(15.0)	(16.9)	(0.6)	(11.2)	(22.9)
Net int. bear. Debt/equity (%)	19.3	73.3	20.5	7.8	(26.8)	(27.6)	(0.9)	(14.2)	(25.2)
Interest expenses	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.1
Interest coverage (X)	23.8	47.8	32.4	60.6	44.9	31.6	50.9	63.9	147.1

Source: Company data and Leading Research Center

Section 5: What is the management philosophy?

Emphasis on product quality and debt free management

From a low level employee to the largest share holding CEO

Woorim's CEO, Mr. Kyuseok Han, joined Woorim in 1983, a small industrial reducer manufacturer then, as a low level employee and spent the next 15 years working at almost every department of the company including accounting, raw material purchasing and production management. He became the CEO by taking over the company in 1998. He decided to expand into the excavator reducer market and secured Doosan Mottrol and Nabtesco as major clients in the early 2000s. Mr. Han is the largest shareholder of the company with a 59.4% (5.35mn shares) stake.

In charge of every part of the company

Mr. Han is in charge of every part of the company's operation with a full knowledge of the company. It is known that he is particularly good at personnel and financial management. Two main management priorities are an emphasis on product quality and debt free management.

Table 3. CEO profile

Period	Professional experience
1998 ~ Present	President, Woorim Machinery
1998	Took over Woorim Machinery
1997	Director, Production Management Department, Woorim Machinery
1983	Joined Woorim Machinery
	Education
	BS in Engineering Management, Gyeongnam Industrial College

Source: Company data

Section 6: Peer group comparison

Difficult to find comparable peers

Among the selected peer group companies in the table below, there is no specialized ER and IR manufacturer. DIC (092200 KS) and DongYang Mechatronics are automobile parts manufacturers. Although DIC started manufacturing ERs beginning this year, ER production represents a very small portion of the company's revenue and therefore it is too early to classify the company as a reducer manufacturer. Jinsung TEC (036890 KS) manufactures undercarriage parts for heavy machinery equipments, mainly rollers. Hyosung Corp. (004800 KS) is the largest IR manufacturer, but its main business areas are trading and textile production with IRs representing a tiny portion of its overall revenues. Other major ER manufacturers such as Sungbo P&T and Sunjin Powertech are not listed.

Woorim undervalued relative to the market and peers on an EV/EBITDA basis

Comparisons with the selected peer group companies may not provide clear investment guidelines as their operations do not significantly overlap with Woorim's. Nevertheless, we believe peer comparisons may be used as a reference to some extent since they are all machinery/parts manufactures. Woorim does not look much appealing on a P/E basis, but undervalued on an EV/EBITDA base relative to peer group companies and the market (7.7x for 2011E and 6.9x for 2012E). Given capital intensive nature of the machinery/parts industry, we believe EV/EBITDA is the most appropriate valuation measure for Woorim.

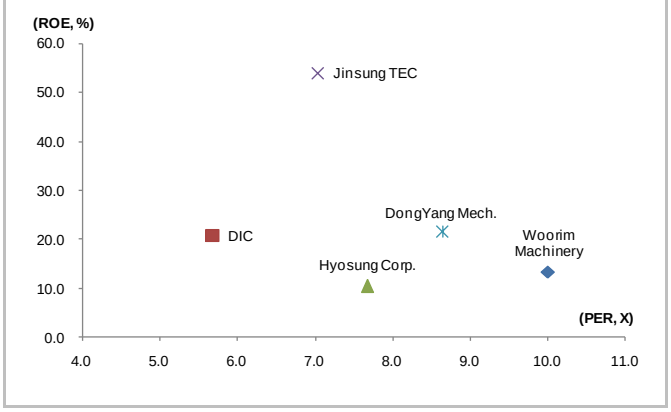
Table 4. Peer group comparison

Company	Ticker	Mkt Cap (Wbn)	Sales (Wbn)				OP margin (%)			
			09	10	11E	12E	09	10	11E	12E
Woorim Machinery	**101170 KQ**	**85.2**	**44.2**	**50.3**	**78.9**	**101.4**	**22.7**	**13.4**	**12.9**	**12.6**
DIC	092200 KS	141.1	183.3	254.7	318.6	354.0	2.0	5.7	7.0	7.3
Hyosung Corp.	004800 KS	2,602.2	7,039.7	8,192.1	9,947.0	10,589.1	7.6	6.1	5.2	6.0
Jinsung TEC	036890 KS	134.9	65.8	119.5	168.8	203.4	0.8	6.6	10.3	10.8
DongYang Mech.	013570 KS	446.5	281.3	473.9	599.2	673.0	2.1	5.6	7.1	7.4

Company	PER (X)				EV/EBITDA (X)				P/B (X)				ROE (%)			
	09	10	11E	12E	09	10	11E	12E	09	10	11E	12E	09	10	11E	12E
Woorim Machinery	**10.9**	**11.6**	**10.0**	**7.8**	**6.9**	**5.3**	**5.9**	**4.2**	**1.8**	**1.2**	**1.3**	**1.1**	**19.6**	**10.9**	**13.2**	**14.9**
DIC		16.4	5.7	4.5	7.7	7.5	5.0	4.2	0.7	1.3	1.1	0.9	(3.7)	8.5	20.8	21.4
Hyosung Corp.	8.4	13.0	7.7	5.7	6.7	7.7	6.4	5.3	1.0	1.2	0.8	0.7	13.4	8.6	10.5	12.8
Jinsung TEC		11.6	7.0	5.5	36.3	15.1			7.4	5.2	2.8		(5.9)	59.7	54.0	43.5
DongYang Mech.	10.3	7.2	8.6	7.0	9.3	10.3	9.3	7.9	0.8	1.6	1.7	1.4	7.5	24.3	21.5	20.9

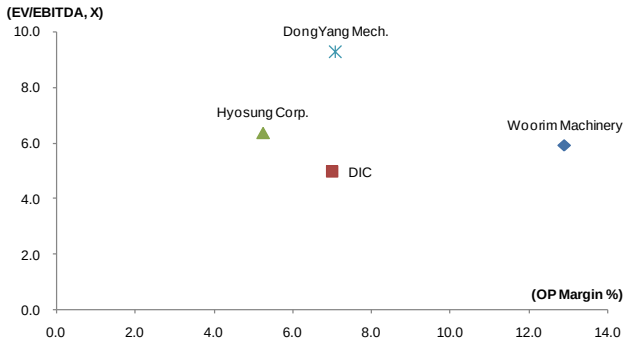
Source: Bloomberg and Leading Research Center

Chart 16. A peer group PER vs. ROE



Source: Bloomberg and Leading Research Center

Chart 17. A peer group EV/EBITDA vs. OP margin



Source: Bloomberg and Leading Research Center

Section 7: FX exposure and sensitivity

Around 25% of revenue is exposed to US$ - An 1% change in FX rate to change EPS 1.9%

The export portion in the company's total revenue continued to decline from 27% in 2008 to as low as 16% in 2010. While exports increased to 25% of total revenue in 1H11 reflecting overseas order increases including natural gas drilling reducer from OCG, we estimate the export portion will fall to 21% for the full year 2011, 19% in 2012 and 18% in 2013 based on the expected increase in domestic ER supply to Doosan Mottrol. Almost 100% of the company exports are settled in US$ and fully exposed to FX rate changes as raw material imports are negligible amounting to around W0.2bn per year. However, exports still represent a relatively small portion of total revenue and therefore FX rate changes are not major risk for the company.

Table 5. 2011E FX sensitivity

% chg in KRW/US$ rate	-5%	-1%	Base	1%	5%
Year-end KRW/US$	1,020	1,063	1,074	1,085	1,128
Year-avg KRW/US$	1,028	1,071	1,082	1,093	1,136
Revenue (Wbn)	78.1	78.8	78.9	79.1	79.8
Operating profit (Wbn)	9.4	10.0	10.2	10.3	11.0
NP (Wbn)	7.7	8.4	8.5	8.7	9.4
EPS (W)	860	932	950	967	1,039
P/E (X)	11.0	10.2	10.0	9.8	9.1
Revenue change (%)	(1.0)	(0.2)	0.0	0.2	1.0
OP change (%)	(7.9)	(1.6)	0.0	1.6	7.9
NP change (%)	(9.4)	(1.9)	0.0	1.9	9.4
EPS change (%)	(9.4)	(1.9)	0.0	1.9	9.4

Source: Company data and Leading Research Center

Table 6. 2012F FX sensitivity

% chg in KRW/US$ rate	-5%	-1%	Base	1%	5%
Year-end KRW/US$	960	1,001	1,011	1,021	1,062
Year-avg KRW/US$	979	1,020	1,030	1,040	1,082
Revenue (Wbn)	100.4	101.2	101.4	101.5	102.3
Operating profit (Wbn)	11.8	12.6	12.8	13.0	13.7
NP (Wbn)	10.0	10.7	10.9	11.1	11.9
EPS (W)	1,110	1,194	1,215	1,236.1	1,320.1
P/E (X)	8.5	7.9	7.8	7.7	7.2
Revenue change (%)	(1.0)	(0.2)	0.0	0.2	1.0
OP change (%)	(7.4)	(1.5)	0.0	1.5	7.4
NP change (%)	(8.6)	(1.7)	0.0	1.7	8.6
EPS change (%)	(8.6)	(1.7)	0.0	1.7	8.6

Source: Company data and Leading Research Center

Table 7. 2013F FX sensitivity

% chg in KRW/US$ rate	-5%	-1%	Base	1%	5%
Year-end KRW/US$	1,014	1,056	1,067	1,078	1,120
Year-avg KRW/US$	1,002	1,044	1,055	1,066	1,108
Revenue (Wbn)	119.5	120.4	120.6	120.8	121.7
Operating profit (Wbn)	13.7	14.5	14.7	14.9	15.8
NP (Wbn)	11.8	12.6	12.8	13.0	13.9
EPS (W)	1,306	1,400	1,423	1,447.0	1,540.8
P/E (X)	7.3	6.8	6.7	6.5	6.1
Revenue change (%)	(0.9)	(0.2)	0.0	0.2	0.9
OP change (%)	(7.2)	(1.4)	0.0	1.4	7.2
NP change (%)	(8.2)	(1.6)	0.0	1.6	8.2
EPS change (%)	(8.2)	(1.6)	0.0	1.6	8.2

Source: Company data and Leading Research Center

Section 8: Operations overview and earnings forecast

Excavator reducer (ER)

Woorim is the only listed excavator reducer manufacturer

It is difficult to draw a full picture of the ER market due to the absence of market data. Sungbo P&T and Sunjin Powertech are major domestic excavator and forklift reducer manufacturers other than Woorim and DIC, an automobile parts and heavy equipment producer, has recently entered the ER market. Among these ER manufacturers, it is known that Sungbo P&T is the largest in terms of sales volume, followed by Sunjin Powertech and Woorim. It is too early to classify DIC as an ER manufacturer since its ER revenue is estimated at only W3bn in 2011 and it will take several years for DIC to capture a meaningful market share.

Close business relationships between ER manufactures and their clients

Excavator parts production and capacity expansion are implemented under technical collaboration and discussions with excavator assemblers and hydraulic component suppliers to assemblers. As such, ER manufacturers typically form a supply chain with specific assemblers and component suppliers. Sungbo P&T is in the Hyundai Heavy's supply chain and other manufacturers including Woorim supply mostly to Doosan Mottrol and other Doosan group affiliates.

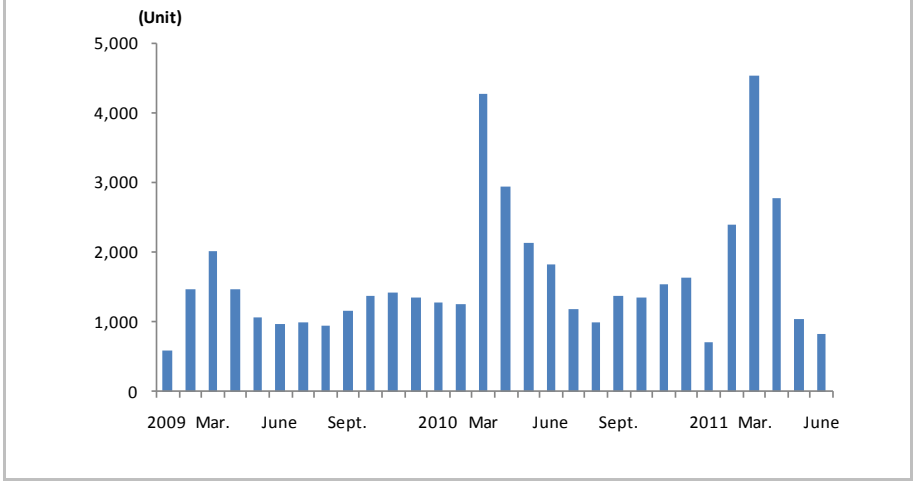
Woorim supplies more than 90% its ERs to Doosan Mottrol

Woorim is the largest ER supplier to Doosan Mottrol accounting for around 80% of Mottrol's total ER purchase. Woorim also supplies ERs to Nabtesco, but ER supply to Nabtesco represents only 5% of Woorim's total ER sales compared to more than 90% to Mottrol. Mottrol supplies its hydraulic components equipped with Woorim's ER to excavator assemblers such as Doosan Infracore, Hyundai Heavy and Volvo. Due to its diverse client base, it is known that Mottrol is able to supply only 30-40% of Doosan Infracore's total hydraulic component demand.

Doosan Infracore suffered excavator sales declines in China in 2Q11

While the excavator market in China cooled down in 2Q11, Doosan Infracore's sales volume in China declined more rapidly than its competitors'. The company has explained that sales in 1Q11 were exceptionally high, but more importantly, its new models introduced in 2Q11 were not well received in the market and Hyundai Heavy's aggressive pricing also hurt its sales. The company plans to make up for sales decline in 2Q11 by reintroducing its previous models in 3Q11.

Chart 18. Doosan Infracore's excavator sales in China



Source: Doosan Infracore

Doosan Mottrol's capacity expansion to increase Woorim's ER sales

We expect no negative impact of Doosan Infracore's excavator sales decline in China on Woorim's ER sales. As mentioned before, Doosan Mottrol has a diverse client base and Infracore has been able to purchase only 30-40% of its hydraulic components from Mottrol. Infracore plans to increase its hydraulic components purchase from its affiliate regardless of its excavator sales in China. As such, even if Infracore's excavator sales in China do not recover in the near future, Mottrol's component supply to Infracore will continue to increase and the construction of Mottrol's new plant in China has been underway as scheduled. Mottrol's total hydraulic component capacity will increase from 200,000 units in 2010 to 476,000 units in 2012.

Table 8. Doosan Mottrol's hydraulic component capacity

(Unit)	2009	2010	2011	2012
Domestic	180,000	200,000	270,000	350,000
China			84,000	126,000
Total	**180,000**	**200,000**	**354,000**	**476,000**

Source: Doosan Mottrol

Woorim's capacity expansion to respond to Mottrol's request to supply more reducers

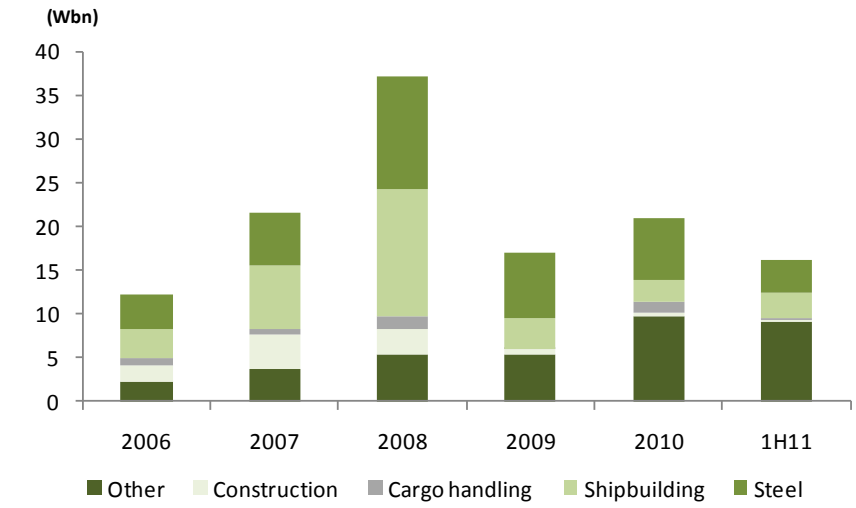
Doosan Mottrol has already requested Woorim to supply 25% more ERs beginning in 4Q11 to meet increasing hydraulic component demand from its clients including local excavator assemblers in China. In order to respond to Mottrol's request and increasing IR orders, Woorim itself is constructing a new plant to be completed in October this year. Upon the completion of the new plant, Woorim's capacity for ER and IR will be expanded to W100bn (from the current W50bn) and W50bn (from W30bn), respectively. The company optimistically expects that new ER capacity will be fully operational as early as 2012.

Industrial reducer (IR)

By refraining from price competition, Woorim maintains IR operating margin at 20%

After the explosive growth during 2006 and 2008, Woorim suffered a 44% decline in IR sales through 2010 due to the completion of capacity expansion at major steel producers and the recession in the shipbuilding industry. Moreover, Hyosung Corp. (004800.KS) started a price war and Woorim lost a significant market share. While Woorim had a similar market share to Hyosung in 2007, it is estimated that Woorim's market has declined to around 30% of Hyosung's. The price war has been subsided to some extent. It is known that the price war hurt Hyosung the most as its IR division is operating at near breakeven. Woorim also decided to refrain from price competition in late 2010. Woorim maintains its IR operating margin still high at around 20%.

Chart 19. Woorim's industrial reducer order trend



Source: Company data

Recovery in domestic IR demand

IR orders are on a recovery trend in 2011 as major steel mills have started another around of capacity expansion and shipbuilding orders are increasing. Indeed, Woorim's IR revenue in 1H11 already amounted to more than 70% of total IR revenue in 2010 and we expect a 59% yoy growth in IR revenue to W29.4bn in 2011 from W18.5bn in 2010. Domestic IR revenue increased 12.6% yoy in 1H11 and we expect more revenue in 2H given that domestic steel producers plan to place W18bn worth IR orders.

New IR sales of W10bn to US

While domestic demand is recovering, increasing overseas orders are the major contributor to the overall IR sales growth. The company received natural gas drilling reducer orders worth W6.9bn from Obatan Chicago Gear (OCG) in 1H11 and plans to supply W10bn worth reducers to OCG in 2011. Although there have some concerns over the sustainability of OCG orders, natural gas drilling reducers are replaceable by around 12 months and therefore the company expects to receive W10bn orders from OCG every year unless OCG changes its reducer supplier again.

Wind power generation gear box

Developed gear box jointly with Doosan Heavy and Mottrol

The wind turbine gear box is an application of reducer and used to speed up the rotation speed of the blades fast enough to generate electricity. Woorim developed the gear box under technical collaboration with Doosan Heavy and Doosan Mottrol in 2010. The company's gear box is currently on a testing stage. Given that the gear box was developed jointly with Doosan Heavy, a wind power generation system manufacturer, Woorim expects to supply its gear box to Doosan Heavy upon the successful completion of testing.

Woorim expects W5bn gear box sales in 2012

Doosan Heavy is currently operating a pilot model of wind power generation system and plans to install 100 units of generation system in Jeju Island in 2012. Doosan Heavy already placed 50 gear box orders on a European company and it is known that Doosan Heavy will place the remaining 50 gear box orders on Woorim and a Japanese company. According to Woorim, Doosan Heavy is not obligated to purchase gear box from Woorim, but Doosan is likely to place 20 gear box orders on Woorim. Woorim estimates 20 gear box order would be worth W5bn providing around the same operating margin of 20% as IR.

Skeptical about the long term growth of the wind power generation equipment market

However, we believe the attention to wind power generation after the Fukushima nuclear disaster was temporary and remain skeptical about the long-term growth potential of the wind power generation system equipment market. Wind power generation system is too expensive to install and power generation efficiency is way below compared to fossil fuel and nuclear power generation. Without major breakthrough development in wind power storage and transmission technology, we believe wind power generation has no competitiveness as an alternative power source.

Earnings outlook

Strong 2Q11 results thanks to IR sales growth

Woorim has announced quite strong 2Q11 results with both revenue and operating profit increasing 21% qoq. The single biggest reason for the strong 2Q11 results was that high margin IR revenue rose 34% qoq to account for 41% of total revenue compared to 37% in 1Q11.

Table 9. Quarterly results and outlook

(Wbn)	1Q11	2Q11	*QoQ (%)*	*YoY (%)*	2010	2011	2012	2013
Revenue	15.6	18.8	*20.6*	*65.2*	50.3	78.9	101.4	120.6
ER	9.8	11.1	*12.6*	*52.7*	31.8	49.5	65.8	82.5
IR	5.7	7.7	*34.4*	*87.2*	18.5	29.4	35.6	38.1
Operating profit	2.2	2.6	*21.0*	*112.4*	6.7	10.2	12.8	14.7
Pretax profit	2.3	2.9	*26.4*	*57.6*	8.0	10.7	13.7	16.0
Net income	1.8	2.4	*35.7*	*61.2*	6.4	8.5	10.9	12.8
Revenue breakdown (%)								
ER	63.1	58.9			63.2	62.7	64.9	68.4
IR	36.9	41.1			36.8	37.3	35.1	31.6
Profit margin (%)								
Operating	13.8	13.9			13.4	12.9	12.6	12.2
Pretax	14.7	15.4			15.9	13.5	13.5	13.3
Net	11.4	12.8			12.8	10.8	10.8	10.6

Source: Company data and Leading Research Center

IR exports to OCG more than doubled in 2Q11

Strong exports (up more than 50% qoq accounting for 56% of total IR revenue in 2Q11) led the overall IR revenue growth. Exports to OCG more than doubled to W3.9bn in 2Q11 from W1.8bn in 1Q11. There have been some concerns that Woorim will not be able to benefit from a recovery in domestic IR demand due to price competition with Hyosung and therefore received orders from OCG at even lower price than domestic price only to make up for revenue loss in the domestic market. However, we believe such arguments have proved to be groundless as the company's overall profit margin slightly improved in 2Q11 despite sharp increase in OCG exports and domestic sales also increased 16% qoq.

Table 10. Quarterly industrial reducer revenue and revenue breakdown

(Wmn)	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11
Total	5,013	4,129	4,363	5,014	5,750	7,727
Domestic	3,424	2,956	2,258	3,322	2,933	3,395
Export	1,589	1,173	2,105	1,692	2,817	4,332
Breakdown (%)						
Domestic	68.3	71.6	51.8	66.2	51.0	43.9
Export	31.7	28.4	48.2	33.8	49.0	56.1
Operating margin (%)	18.1	10.8	11.2	13.7	13.8	13.9

Source: Company data

Revenue and operating profit to increase 57% yoy and 52% yoy, respectively, in 2011

We estimate the company's revenue will increase 57% yoy to W79bn in 2011 given its plan to increase ER supply to Doosan Mottrol and expected IR orders from major steel producers in 2H11. Operating profit will increase 52% yoy to W10.2bn. We assume a lower operating margin of 12.9% in 2011 relative to 13.8% in 1H11 as lower margin ER supply to Mottrol will increase faster than IR sales and depreciation charges will increase as well upon the completion of the new plant in 2H11.

Per annum growth of more than 20% yoy in both revenue and operating profit during 2012 and 2013

We expect per annum growth of more than 20% yoy in both revenue and operating profit during 2012 and 2013 benefiting from capacity expansion at Doosan Mottrol and Woorim itself. We assume that IR exports to OCG will be maintained at W10bn level and wind power generation gear box supply to Doosan Heavy will generate additional IR revenue of W5bn in 2012. Operating margin will continue to decline due to increasing portion of ERs in total revenue, but will be maintained at above 12%. The company has indicated that IR revenue of W100bn is possible even in 2012, but we conservatively assume ER revenue of W65bn.

Casting metal, a major raw material for reducers, is in supply shortage

The major risk to the company's own revenue expectation and even our forecast is availability of casting metal. Casting metal, accounting for around 25% of the company raw materials, is in supply shortage. Most casting metal producers in Korea are small-scale companies with limited capital resources and therefore have not been able to expand their capacity despite demand increase. Casting metal producers are allocating more volume to their biggest clients, automobile assemblers and parts producers. The company has indicated that while it procured casting metal from adjacent areas in the past, it has already started contacting other producers in remote areas and there will be no major production setback.

Section 9: Valuation – Target price of W12,400

A 31% upside potential

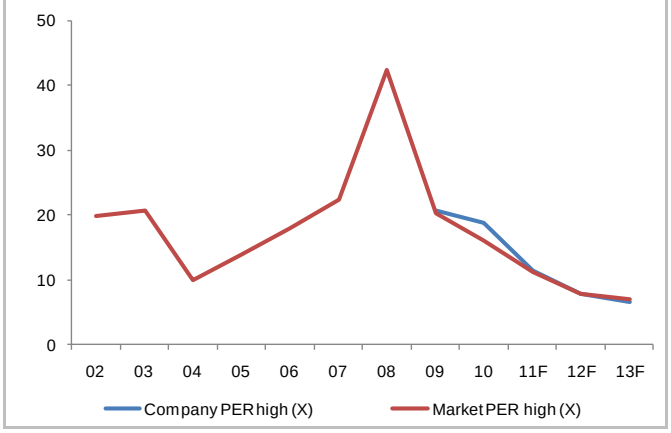
There are not sufficient share price data to assess whether the company shares are overvalued or undervalued relative to the stock market as the company was listed only two years ago in April 2009. Nevertheless, the shares have consistently traded at premiums over the market since its listing on a P/E basis. Although the shares have traded at a discount on an EV/EBITDA basis since 2010, we expect the discount will gradually disappear in line with strong growth in the company's revenue and earnings. While we believe the company deserves the premium of 16.9% in 2009, we have conservatively applied the market 2011F EV/EBITDA of 7.7x in deriving our target price of W12,400.

Table 11. Premium/(discount) in Woorim PER relative to market PER

(X)	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011E	2012F	2013F
Woorim's high PER								20.7	18.8	11.4	7.8	6.7
Market high PER	19.9	20.7	9.9	13.9	17.9	22.3	42.4	20.4	16.0	11.2	7.8	7.0
Premium/(Discount) to market (%)								**1.7**	**17.8**	**1.5**	**(0.2)**	**(4.8)**
Woorim's low PER								10.0	10.9	8.2	7.8	6.7
Market low PER	9.9	10.2	5.7	7.2	11.0	10.9	16.2	9.8	9.6	8.6	7.8	7.0
Premium/(Discount) to market (%)								**1.9**	**12.6**	**(4.9)**	**(0.2)**	**(4.8)**

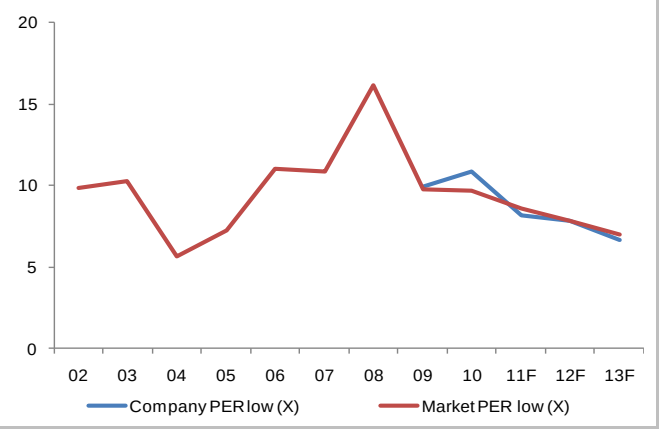
Source: FnGuide and Leading Research Center

Chart 20. Year-high PER trend



Source: FnGuide and Leading Research Center

Chart 21. Year-low PER trend



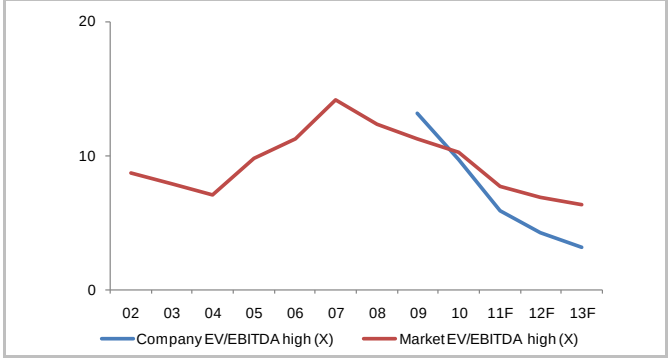
Source: FnGuide and Leading Research Center

Table 12. Premium/(discount) in Woorim EV/EBITDA relative to market EV/EBITDA

(X)	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011E	2012F	2013F
Woorim's high EV/EBITDA								13.2	9.7	5.9	4.2	3.1
Market high EV/EBITDA	8.7	7.9	7.1	9.8	11.3	14.2	12.3	11.3	10.3	7.7	6.9	6.3
Premium/(Discount) to market (%)								**16.9**	**(5.5)**	**(23.8)**	**(38.6)**	**(50.4)**
Woorim's low EV/EBITDA								5.7	4.9	5.9	4.2	3.1
Market low EV/EBITDA	5.7	5.2	4.9	6.2	7.7	7.8	6.0	6.5	6.7	7.7	6.9	6.3
Premium/(Discount) to market (%)								**(12.8)**	**(26.2)**	**(23.8)**	**(38.1)**	**(50.4)**

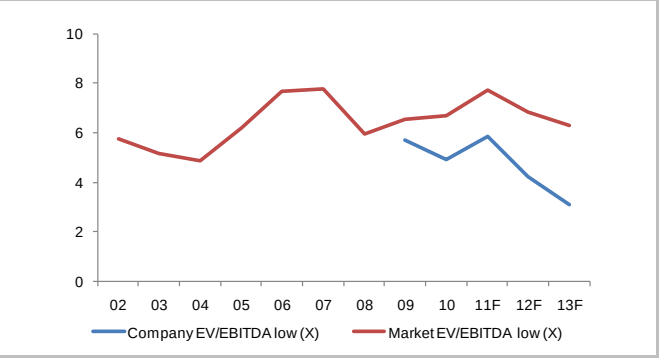
Source: FnGuide and Leading Research Center

Chart 22. Year-high EV/EBITDA trend



Source: FnGuide and Leading Research Center

Chart 23. Year-low EV/EBITDA trend



Source: FnGuide and Leading Research Center

Summary of financials

Income statement

(Wbn)	2005	2006	2007	2008	2009	2010	2011F	2012F	2013F
Revenue	**12.1**	**19.7**	**31.5**	**53.9**	**44.2**	**50.3**	**78.9**	**101.4**	**120.6**
% chg yoy	N/A	63.0	59.7	71.2	(18.1)	13.9	57.0	28.4	19.0
COGS	8.6	13.8	21.9	36.8	30.8	39.6	62.5	80.5	96.0
Gross profit	**3.5**	**5.9**	**9.6**	**17.1**	**13.3**	**10.7**	**16.4**	**20.9**	**24.6**
GP margin (%)	28.9	30.0	30.5	31.7	30.1	21.2	20.8	20.6	20.4
SG&A	**1.3**	**1.1**	**1.9**	**3.0**	**3.3**	**3.9**	**6.2**	**8.1**	**9.9**
Operating income	**2.2**	**4.8**	**7.7**	**14.1**	**10.0**	**6.7**	**10.2**	**12.8**	**14.7**
OP margin (%)	18.2	24.4	24.5	26.2	22.7	13.4	12.9	12.6	12.2
Non-operating income	0.1	0.1	0.4	1.1	1.3	1.8	1.3	1.8	2.1
Interest income	0.0	0.1	0.0	0.0	0.4	0.8	0.2	0.6	1.0
FX gains	0.0	0.0	0.0	0.2	0.2	0.1	0.2	0.1	0.0
Equity method gain	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Non-operating expenses	0.1	0.2	0.6	1.8	1.2	0.6	0.8	0.9	0.8
Interest expenses	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.1
FX losses	0.0	0.0	0.0	1.1	0.8	0.2	0.3	0.2	0.2
Equity method loss	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Profit before tax	**2.2**	**4.7**	**7.6**	**13.5**	**10.2**	**8.0**	**10.7**	**13.7**	**16.0**
Tax	0.5	0.9	1.4	2.5	1.6	1.6	2.1	2.7	3.2
Tax rate (%)	24.6	19.0	18.5	18.5	15.4	19.7	20.0	20.0	20.0
Net income	**1.6**	**3.8**	**6.2**	**11.0**	**8.6**	**6.4**	**8.5**	**10.9**	**12.8**

Balance sheet

(Wbn)	2005	2006	2007	2008	2009	2010	2011F	2012F	2013F
Cash & equivalents	0.2	0.3	0.4	2.0	1.9	16.0	2.6	13.4	25.1
A/R	3.4	3.1	7.3	13.1	11.9	16.9	23.7	30.4	36.2
Other quick assets	0.3	0.6	0.6	1.0	0.9	0.5	4.0	4.0	5.0
Total quick assets	4.1	4.0	8.4	16.2	29.8	36.6	30.3	47.8	66.3
Inventory	0.7	1.0	3.2	5.9	4.1	6.4	8.1	10.5	12.5
Total current assets	**4.9**	**5.0**	**11.6**	**22.1**	**33.9**	**43.0**	**38.4**	**58.3**	**78.8**
Investments	0.0	0.0	0.2	1.1	1.2	1.2	1.3	1.3	1.3
Tangible assets	3.0	13.5	16.6	21.8	31.2	32.6	51.2	48.0	45.0
Others	0.5	0.8	0.9	1.5	1.8	2.8	2.5	2.5	2.5
Total non-current assets	**3.5**	**14.3**	**17.7**	**24.4**	**34.3**	**36.7**	**55.0**	**51.8**	**48.8**
Total assets	**8.4**	**19.2**	**29.3**	**46.5**	**68.2**	**79.7**	**93.4**	**110.1**	**127.6**
Trade Payables	1.7	3.0	5.2	7.5	7.6	12.3	18.8	24.1	28.8
Short-term borrowings	0.5	5.9	1.4	1.4	0.0	0.0	0.0	0.0	0.0
Current portion of LT debt	0.0	0.5	0.1	2.4	0.0	0.1	0.2	0.2	0.2
Others	0.6	1.0	3.2	5.7	1.9	3.3	4.0	4.5	4.8
Total current liabilities	**2.8**	**10.3**	**9.8**	**16.9**	**9.4**	**15.7**	**23.0**	**28.8**	**33.8**
Bonds	0.0	0.0	0.0	0.0	2.1	2.3	0.0	0.0	0.0
Long-term debt	0.9	0.1	2.6	0.6	0.2	0.1	1.8	2.0	2.0
Allowance for retirement reserve	0.1	0.2	0.2	0.3	0.1	0.1	0.1	0.1	0.1
Others	0.0	0.2	0.2	0.2	0.2	0.2	0.4	0.5	0.6
Total LT liabilities	**0.9**	**0.5**	**3.0**	**1.1**	**2.6**	**2.8**	**2.3**	**2.6**	**2.7**
Total liabilities	**3.8**	**10.9**	**12.8**	**18.1**	**12.1**	**18.4**	**25.3**	**31.4**	**36.5**
Paid-in capital	1.7	1.7	3.4	3.5	4.5	4.5	4.4	4.4	4.4
Capital surplus	0.0	0.0	0.2	1.1	19.2	19.2	19.2	19.2	19.2
Retained earnings	3.0	6.7	12.8	23.8	32.4	38.5	46.6	57.1	69.5
Capital adjustments	0.0	0.0	0.0	0.0	0.0	(1.0)	(2.0)	(2.0)	(2.0)
Total shareholder's equity	**4.6**	**8.3**	**16.5**	**28.5**	**56.1**	**61.2**	**68.2**	**78.7**	**91.0**

Free cashflow analysis

(Wbn)	2005	2006	2007	2008	2009	2010	2011F	2012F	2013F
Net profit	**1.6**	**3.8**	**6.2**	**11.0**	**8.6**	**6.4**	**8.5**	**10.9**	**12.8**
add non-cash expenses	**0.8**	**1.0**	**1.9**	**3.1**	**3.1**	**5.3**	**5.7**	**6.4**	**7.0**
Depreciation	0.7	0.9	1.5	1.8	2.4	3.9	4.2	4.8	5.2
Equity method losses	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other non-cash expenses	0.1	0.2	0.4	1.3	0.8	1.3	1.5	1.6	1.8
subtract non-cash incomes	**0.0**	**0.0**	**0.2**	**0.0**	**0.0**	**0.1**	**0.4**	**0.2**	**0.1**
Equity method gains	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other non-cash incomes	0.0	0.0	0.2	0.0	0.0	0.1	0.4	0.2	0.1
subtract investment in W/C	2.4	(1.3)	4.2	6.3	(3.2)	2.7	2.0	3.7	3.1
Cash from operation	**1.1**	**6.3**	**4.9**	**8.3**	**10.0**	**8.5**	**11.8**	**13.5**	**16.6**
subtract capital expenditure	0.5	11.4	5.1	7.2	11.8	5.8	23.5	6.0	6.0
Free cash flow	**0.7**	**(5.1)**	**(0.2)**	**1.0**	**(1.9)**	**2.7**	**(11.7)**	**7.5**	**10.6**
Dividend	0.0	0.0	0.0	0.0	0.0	0.0	0.4	0.4	0.4
Net investments	0.0	0.0	0.2	1.0	0.1	0.1	0.1	0.0	0.0
Share issues	0.0	0.0	2.0	1.0	19.0	0.0	0.0	0.0	0.0
Increase in debt	1.3	5.1	(2.4)	0.4	(2.1)	0.2	(0.5)	0.2	0.0
Others	1.8	(0.1)	(0.9)	(0.1)	15.1	(11.4)	(0.4)	(5.1)	(3.3)
Net cash flow	**0.2**	**0.1**	**0.1**	**1.6**	**(0.2)**	**14.2**	**(12.3)**	**12.3**	**13.4**
Beginning cash	0.0	0.2	0.3	0.4	2.0	1.9	16.0	3.8	16.1
Ending cash	0.2	0.3	0.4	2.0	1.9	16.0	3.8	16.1	29.5

Key ratios and stability ratios

Year-end 31 Dec (Wbn)	2005	2006	2007	2008	2009	2010	2011F	2012F	2013F
Current ratio	171.8	47.9	118.1	130.6	358.9	273.7	167.3	202.0	233.0
Quick ratio	128.0	32.6	78.4	89.4	145.7	210.0	114.5	151.9	181.3
Inventory holding period (days)	N/A	22.7	34.9	45.2	59.1	48.2	42.4	42.2	43.6
A/R collection period (days)	N/A	59.7	59.9	69.1	103.5	104.7	93.9	97.4	100.8
A/P period (days)	N/A	61.0	62.1	58.5	94.8	86.5	88.1	94.5	98.6
Interest bear debt (Wbn)	1.3	6.5	4.1	4.5	2.3	2.5	2.0	2.2	2.2
Interest bear debt/equity (%)	0.4	0.3	0.7	2.2	17.3	19.4	2.6	13.4	25.1
Net int. bear debt (Wbn)	0.9	6.1	3.4	2.2	(15.0)	(16.9)	(0.6)	(11.2)	(22.9)
Net debt/equity (%)	19.3	73.3	20.5	7.8	(26.8)	(27.6)	(0.9)	(14.2)	(25.2)
Liability/equity (%)	81.4	130.4	77.9	63.5	21.6	30.1	37.1	40.0	40.1

Valuations and margins

	2005	2006	2007	2008	2009	2010	2011F	2012F	2013F
EV/EBITDA (X)	22.1	12.4	7.3	4.1	5.7	6.4	5.9	4.2	3.1
EPS (W)	242	569	915	1,630	955	715	950	1,215	1,423
EPS y-y (%)	N/A	134.8	60.8	78.2	(41.4)	(25.2)	32.9	28.0	17.1
PER (X)	39.1	16.7	10.4	5.8	9.9	13.2	10.0	7.8	6.7
BVPS (W)	688	1,239	2,449	4,229	7,130	6,804	7,573	8,740	10,115
P/BVPS (X)	13.8	7.7	3.9	2.2	1.3	1.4	1.3	1.1	0.9
Dividend (W)					50	50	50	50	50
Yield (%)					0.5	0.5	0.5	0.5	0.5
ROE (%)	N/A	59.1	49.6	48.8	20.3	11.0	13.2	14.9	15.1
ROA (%)	N/A	27.7	25.4	28.9	15.0	8.7	9.9	10.7	10.8
GP margin (%)	28.9	30.0	30.5	31.7	30.1	21.2	20.8	20.6	20.4
OP margin (%)	18.2	24.4	24.5	26.2	22.7	13.4	12.9	12.6	12.2
NP margin (%)	13.5	19.4	19.6	20.4	19.5	12.8	10.8	10.8	10.6
EBITDA margin (%)	24.2	28.7	29.2	29.5	28.1	21.3	18.2	17.3	16.5
ROIC (%)	N/A	39.0	36.8	46.6	24.3	13.0	14.9	15.4	17.7
WACC (%)	N/A	N/A	N/A	N/A	10.5	10.6	10.1	12.3	12.4
ROIC less WACC (%)	N/A	N/A	N/A	N/A	13.7	2.4	4.8	3.1	5.3

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