

13 March 2012

Produced by: RBS Asia Limited (Seoul) Branch

Buy

Target price
W245000.00

Price
W151500.00

Kumho Petrochemical

Delayed recovery

Kumho is likely to announce worse-than-expected 1Q12 due to delayed demand pick-up in synthetic rubber. Kumho has underperformed KOSPI by 23.3% in the past three months due to soaring butadiene price (raw material); however, butadiene price is stabilized. We expect demand to pick in 2H12.

1Q12 likely to be disappointing

- Kumho Petrochem is likely to announce worse-than-expected 1Q12 due to delayed demand pick-up in synthetic rubber in China and soaring butadiene price. We expect 1Q12 revenue and operating profit to be W1,564bn and W120bn (7.7% opm), respectively. OP is likely to be 18% lower than 28 day consensus of W146bn.
- By division, we expect synthetic rubber to post 8.5% opm and synthetic resin and phenol to record 2.0% and 6.0% opm, respectively.

No specific plan for solar business yet

- According to the local news paper (Herald economic), Kumho plans to build a solar-power generation plant (5MW) by 1H13. To achieve this, the company included solar industry in the business description it pursues prior to the shareholders' meeting next week.
- Based on our channel checks, there isn't any specific plan for solar business yet considering solar business still suffer from over-capacities and regulation issues.

Maintain Buy

- We maintain Buy on Kumho Petrochem. Kumho is one of the worst performers in the sector due to rising raw material price; however, it stabilized recently. The recent share price correction makes the valuation more attractive at 5.0x 2012F P/E and 1.9x 2012F P/B.
- We also expect demand is picking up slowly in China in 2H12 as China is likely to boost its consumption in 2H12 with easing monetary policy.

Equity | Korea | Chemicals

Flashnote

1Q12 preview

(Wbn)	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11	3Q11	4Q11	1Q12E	1Q12 Consensus	Diff
Revenue	1,148	1,220	1,276	1,263	1,600	1,708	1,660	1,489	1,564	1,624.8	-3.8%
Synthetic rubbers	498	561	584	591	788	982	946	821	862		
Synthetic resins	288	305	311	316	346	324	274	303	309		
Others	362	354	381	356	466	402	441	365	393		
Phenol	283	248	275	294	348	298	325	257	270		
Fine Chemical	33	40	41	41	49	48	47	42	47		
Combined thermal	54	47	53	56	42	34	38	42	43		
Other	9	33	29	(36)	27	23	31	25	33		
Operating profit (consolidated)	125	143	142	160	289	276	219	110	120.0	166.0	-27.7%
Synthetic rubbers	37	60	47	66	167	167	128	70	73.3		
Synthetic resins	7	18	22	25	31	15	7	4	6.2		
Others	35	62	74	70	90	94	54	36	40.6		
Phenol	14	41	51	55	63	60	44	10	18.2		
Margin (%)											
Operating profit	10.9%	11.7%	11.1%	12.7%	18.0%	16.2%	13.2%	7.4%	7.7%	10.2%	
Synthetic rubbers	7.5%	10.7%	8.0%	11.1%	21.2%	17.0%	13.6%	8.5%	8.5%		
Synthetic resins	2.6%	6.0%	7.1%	7.9%	9.0%	4.6%	2.7%	1.3%	2.0%		
Others	9.6%	17.4%	19.3%	19.5%	19.4%	23.5%	12.3%	9.9%	10.3%		
Phenol	5.0%	16.6%	18.7%	18.7%	18.0%	20.0%	13.5%	4.0%	6.0%		

Source: Company data, RBS forecast

Important disclosures can be found in the Disclosures Appendix.

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Income statement

Wb, year to December	FY09A	FY10A	FY11F	FY12F	FY13F
Revenue	2802	3886	5243	5237	5218
Cost of sales	-2488	-3306	-4262	-4197	-4266
Operating costs	-96.2	-112.1	-137.3	-128.3	-128.7
EBITDA	218.0	468.3	844.1	911.6	822.8
DDA & Impairment (ex gw)	-101.8	-108.7	-112.4	-123.0	-123.5
EBITA	116.2	359.6	731.7	788.5	699.3
Goodwill (amort/impaired)	n/a	n/a	n/a	n/a	n/a
EBIT	116.2	359.6	731.7	788.5	699.3
Net interest	-105.6	-116.8	-118.1	-80.3	-52.5
Associates (pre-tax)	-733.5	145.0	198.9	153.9	217.2
Forex gain / (loss)	26.8	3.91	-29.1	-29.0	-18.9
Exceptionals (pre-tax)	n/a	170.0	n/a	n/a	n/a
Other pre-tax items	-145.8	203.4	-3.65	-5.17	-6.90
Reported PTP	-841.9	765.1	779.7	828.1	838.1
Taxation	227.0	-123.7	-171.5	-182.2	-184.4
Minority interests	n/a	n/a	n/a	n/a	n/a
Exceptionals (post-tax)	n/a	n/a	n/a	n/a	n/a
Other post-tax items	0.00	-0.00	0.00	-0.00	0.00
Reported net profit	-614.8	641.4	608.1	645.9	653.7
Normalised Items Excl. GW	0.00	170.0	0.00	0.00	0.00
Normalised net profit	-614.8	471.4	608.1	645.9	653.7

Balance sheet

Wb, year ended December	FY09A	FY10A	FY11F	FY12F	FY13F
Cash & market secs (1)	80.4	109.0	71.0	108.3	451.7
Other current assets	695.4	781.6	988.4	959.7	954.8
Tangible fixed assets	1357	1423	1449	1526	1531
Intang assets (incl gw)	35.6	26.4	27.7	28.5	29.1
Oth non-curr assets	1032	1096	1427	1586	1809
Total assets	3200	3436	3964	4208	4776
Short term debt (2)	769.9	420.5	420.5	420.5	420.5
Trade & oth current liab	1289	1274	1096	693.6	775.3
Long term debt (3)	585.1	858.4	594.9	635.5	507.2
Oth non-current liab	20.9	2.07	2.07	2.07	2.07
Total liabilities	2665	2555	2113	1752	1705
Total equity (incl min)	535.1	880.3	1851	2457	3071
Total liab & sh equity	3200	3436	3964	4208	4776
Net debt	2150	1951	1408	1007	604.2

Cash flow statement

Wb, year to December	FY09A	FY10A	FY11F	FY12F	FY13F
EBITDA	218.0	468.3	844.1	911.6	822.8
Change in working capital	-49.0	23.3	-128.8	30.5	17.8
Net interest (pd) / rec	-105.6	-116.8	-118.1	-80.3	-52.5
Taxes paid	n/a	n/a	n/a	n/a	n/a
Other oper cash items	218.3	-121.5	-211.3	-216.3	-206.4
Cash flow from ops (1)	281.7	253.2	385.8	645.5	581.6
Capex (2)	-264.1	-174.9	-130.0	-190.0	-120.0
Disposals/(acquisitions)	-199.7	125.2	-131.7	-3.69	-3.88
Other investing cash flow	-4.55	-3.15	-14.7	-15.0	-15.3
Cash flow from invest (3)	-468.4	-52.8	-276.4	-208.7	-139.1
Incr / (decr) in equity	0.00	0.00	398.1	0.00	0.00
Incr / (decr) in debt	129.3	-91.9	-520.1	-363.5	-59.5
Ordinary dividend paid	-17.3	0.00	-25.4	-36.0	-39.6
Preferred dividends (4)	n/a	n/a	n/a	n/a	n/a
Other financing cash flow	142.0	-79.9	0.00	0.00	0.00
Cash flow from fin (5)	253.9	-171.8	-147.4	-399.5	-99.1
Forex & disc ops (6)	n/a	n/a	n/a	n/a	n/a
Inc/(decr) cash (1+3+5+6)	67.3	28.6	-38.0	37.3	343.4
Equity FCF (1+2+4)	17.6	78.3	255.8	455.5	461.6

Source: Company data, RBS forecasts

Recommendation structure

Absolute performance, short term (trading) recommendation (Australian coverage only): A Trading Buy recommendation implies upside of 5% or more from the suggested entry price range, and a Trading Sell recommendation implies downside of 5% or more from the suggested entry price range. The trading recommendation time horizon is 0-60 days.

Absolute performance, long term (fundamental) recommendation: The recommendation is based on implied upside/downside for the stock from the target price and, except as follows, only reflects capital appreciation. A Buy/Sell implies upside/downside of 10% or more and a Hold less than 10%. For research on Australian listed property trusts (LPT) or real estate investment trusts (REIT), the recommendation is based upon total return, ie, the estimated total return of capital gain, dividends and distributions received for any particular stock over the investment horizon.

Performance parameters and horizon: Given the volatility of share prices and our pre-disposition not to change recommendations frequently, these performance parameters should be interpreted flexibly. Performance in this context only reflects capital appreciation and the horizon is 12 months.

Target price: The target price is the level the stock should currently trade at if the market were to accept the analyst's view of the stock and if the necessary catalysts were in place to effect this change in perception within the performance horizon. In this way, therefore, the target price abstracts from the need to take a view on the market or sector. If it is felt that the catalysts are not fully in place to effect a re-rating of the stock to its warranted value, the target price will differ from 'fair' value.

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Long term recommendations (as at 13 Mar 2012)

	Global total (IB%)	Asia Pacific total (IB%)
Buy	577 (3)	513 (3)
Hold	353 (3)	296 (3)
Sell	85 (1)	77 (1)
Total (IB%)	1015 (3)	886 (3)

Source: RBS

Trading recommendations (as at 13 Mar 2012)

	Global total (IB%)	Asia Pacific total (IB%)
Trading Buy	1 (0)	1 (0)
Trading Sell	0 (0)	0 (0)
Total (IB%)	1 (0)	1 (0)

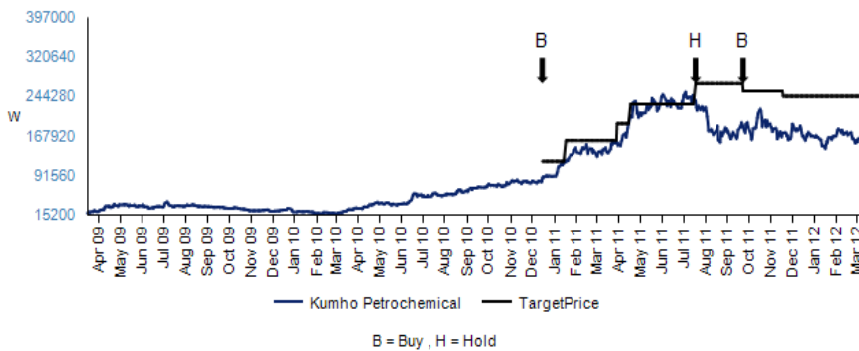
Source: RBS

Valuation and risks to target price

Kumho Petrochemical (RIC: 011780.KS, Rec: Buy, CP: W151500, TP: W245000) We value Kumho on a sum-of-the-parts basis. The downside risks to our target price are a surge in the butadiene price, increasing raw material costs for synthetic rubber and a decreasing self-sufficiency ratio in butadiene due to the renewal of existing contracts with major suppliers. The key upside risk is a strong price spread in synthetic rubbers led by tyre replacement demand in China.

Kumho Petrochem coverage data (011780.KS, 011780 KS)

Stock performance, recommendations and coverage (as at 13 Mar 2012)



Trading recommendation history

Date	Rec	Analyst
n/a	n/a	n/a

Source: RBS

Price perf (at Close 12 Mar 2012)

	(1M)	(3M)	(12M)
Price (W)	170500	187500	141000
Absolute (%)	-11.1	-19.2	7.4
Rel to mkt*(%)	-11.5	-23.3	4.9

Source: Bloomberg
Market: Korea Composite
Sector: Commodity Chemicals

Angela Choi started covering this stock on 14 Dec 10. Moved to new recommendation structure between 1 November 2005 and 31 January 2006.

Regulatory disclosures

RBS beneficially own 1% or more of a class of common equity securities of this company.: **011780.KS**

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