

14 April 2011

Produced by: RBS Asia Limited (Seoul) Branch

Kumho Petrochemical

Preparing for another take-off

Buy

Target price
W230000 (from W192000)

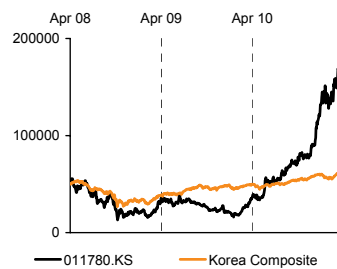
Price
W183000

Short term (0-60 days)
n/a

Market view
Underweight

Price performance

	(1M)	(3M)	(12M)
Price (W)	145000	116000	31400
Absolute (%)	26.2	57.8	482.8
Rel market (%)	16.3	55.3	369.8
Rel sector (%)	19.3	50.4	357.5



Market capitalisation
W4.65t (US\$4.28bn)

Average (12M) daily turnover
W21809.53m (US\$19.25m)

Sector: BBG AP Chemicals
RIC: 011780.KS, 011780 KS
Priced W183000 at close 14 Apr 2011.
Source: Bloomberg

Analysts

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Kumho has announced better-than-expected 1Q11 results and hinted at a strong 2Q. The company is also moving to securitise its butadiene supply and considering investment in S-SBR. We believe these moves could result in structural growth. Buy; TP W230000.

Key forecasts

	FY09A	FY10A	FY11F	FY12F	FY13F
Revenue (Wb)	2,802	3,886	5,410	5,573	5,635
EBITDA (Wb)	218.0	468.3	908.4 ▲	1,001 ▲	1,045 ▲
Reported net profit (Wb)	-614	595.1	675.7 ▲	773.5 ▲	835.2 ▲
Normalised net profit (Wb) ¹	-614	425.1	675.7	773.5	835.2
Normalised EPS (W)	-24,183	16,719	23,474 ▲	25,387 ▲	27,411 ▲
Dividend per share (W)	0.00	1,000	1,250	1,300	1,300
Dividend yield (%)	0.00	0.55	0.68	0.71	0.71
Normalised PE (x)	n/m	10.90	7.80	7.21	6.68
EV/EBITDA (x)	31.20	14.10	6.46	5.32	4.54
Price/book value (x)	8.69	5.29	3.24	2.27	1.72
ROIC (%)	2.70	9.01	22.10	23.70	23.40

Use of ▲ ▼ indicates that the line item has changed by at least 5%.

1. Post-goodwill amortisation and pre-exceptional items

Accounting standard: Local GAAP

Source: Company data, RBS forecasts

year to Dec, fully diluted

Better-than-expected 1Q11

Kumho announced 1Q11 preliminary results after the market close. As this was the first period for which the company has applied IFRS accounting rules, it is hard to make an apples-to-apples comparison with Bloomberg consensus and our forecasts. However, detailed operating margin data showed a better-than-expected 1Q11. OPM for synthetic rubber was slightly above 21% (vs our 17% forecast and 4Q10's 11.1%) with OPM for synthetic resin at 9% (vs our 7.3% forecast and 4Q10's 7.9%). As a result, net profit was 19% higher than our forecast. The main difference between the results and our forecasts comes from a laggard effect: Kumho raises synthetic rubber prices to match market prices; however, its raw material prices lag market prices by one or two months.

We raise 2011 and 2012 EPS by 14% and 22% and our target price to W230,000

Following a better-than-expected 1Q11, we raise our 2011 and 2012 EPS forecasts by 14.1% and 22.5%, respectively. We also raise our TP to W230,000 to reflect our earnings revision and the shift in valuation of Kumho Polychem and Mitsui Chem (two subsidiaries under IFRS accounting) to 5x 2011F EV/EDBITDA from investment book value to reflect the subsidiaries' solid operations. Our new target price provides 26% upside potential.

Seeking structural growth

We believe investors' interest in Kumho will shift from its short-term operational improvement to the long-term strategy. Kumho recently signed an MOU with Philippine JG Summit Petrochemical Corp. to securitise its butadiene supply. In addition, according to management, Kumho is considering investing in solution-SBR, a chemical used in energy-efficient tyres, to reinforce its leading position in synthetic rubbers. Kumho P&B (a previous subsidiary but included in the main operation under IFRS) and Kumho Polychem also plan to increase their capacity for phenol and ethylene propylene diene methylene-linkage by around 70% by 2013.

Important disclosures can be found in the Disclosures Appendix.

Table 1 : 1Q11 results detail

(Wbn)	1Q10	4Q10	1Q11	YoY	QoQ
Revenue	1,147.9	1,263.1	1,600.2	39.4%	26.7%
Synthetic rubbers	497.9	591.0	787.7	58.2%	33.3%
Synthetic resins	288.3	316.0	346.2	20.1%	9.6%
Others	361.7	356.1	466.3	28.9%	30.9%
Phenol	282.9	294.4	348.2	23.1%	18.3%
Fine Chemical	32.5	27.5	49.4	52.0%	79.6%
Combined thermal	37.6	25.2	41.7	10.9%	65.5%
Other	8.7	9.0	27.0	210.3%	200.0%
Operating profit	125.1	164.9	288.5	130.6%	75.0%
Pretax profit	109.2	148	279.2	155.7%	88.6%
Net profit	82.1	76	185.6	126.1%	144.2%
OP margin	10.9%	13.1%	18.0%		
PTP margin	9.5%	11.7%	17.4%		
NP margin	7.2%	6.0%	11.6%		

Source: Company data

Table 2 : Earnings revision

(Wbn)	2011F			2012F		
	Now	Before	Chg	Now	Before	Chg
Revenue	5,410	5,323	1.6%	5,573	5,374.9	3.7%
Operating profit	802	696	15.2%	894	717.3	24.6%
Pre-tax profit	866	759	14.1%	992	809.3	22.5%
Net profit	676	592	14.1%	773	631.2	22.5%
EBITDA	908	802	13.2%	1,001	824.6	21.4%
EPS (W)	23,474	20,567	14.1%	25,387	20,718.4	22.5%

Source: RBS forecasts

Table 3 : Comparison with consensus

(Wbn)	2011F			2012F		
	RBS	Consensus	Diff	RBS	Consensus	Diff
Revenue	5,410	5,309	1.9%	5,573	5,516	1.0%
Operating profit	802	752	6.6%	894	719	24.4%
Pre-tax profit	866	842	2.9%	992	830	19.5%
Net profit	676	656	3.0%	773	642	20.5%
EBITDA	908	919	-1.2%	1,001	846	18.4%
EPS (W)	23,474	23,631	-0.7%	25,387	22,687	11.9%

Source: RBS forecasts, Bloomberg consensus estimates

Table 4 : We increase our SOTP-based target price to W230,000 (from W192,000)

Company	Business	Stake	Valuation methodology	(Wbn)
Main operation	Synthetic rubbers, synthetic resin		6x EV/EBITDA	5,450
Other assets				
Kumho Polychem	EPM (Copolymer of ethylene and propylene), EPDM (Terpolymer of ethylene, propylene and a non-conjugated diene)	50%	5x 2011F EV/EBITDA reflecting narrow production scope	252
Kumho Mitsui Chem	MDI (Methylene diphenyl diisocyanate), Aniline	50%	5x 2011F EV/EBITDA reflecting narrow production scope	153
Kumho P&B	Cumene, Phenol, BPA, Epoxy resins	78%	5x 2011F EV/EBITDA reflecting narrow production scope	964
Kumho Petro Holdings	Holding companies of five J/Vs in China	100%	Book value	71
Sub total				1,439
Treasury shares	22% of total shares		Based on W183,000 share price	1,023
Other assets	Assets related with Kumho Asiana group			334
Net debt				1,215
Equity value				7,032
No. of shares				30,467,693
Per share equity value (W)			Rounding from W230,802	230,000
Current share price (W)				183,000
Upside potentials				25.7%

Source: Company data, RBS forecasts

Income statement

Wb	FY09A	FY10A	FY11F	FY12F	FY13F
Revenue	2802	3886	5410	5573	5635
Cost of sales	-2488	-3306	-4346	-4386	-4394
Operating costs	-96.2	-112.1	-155.7	-185.6	-195.2
EBITDA	218.0	468.3	908.4	1001	1045
DDA & Impairment (ex gw)	-101.8	-108.7	-106.4	-107.2	-107.7
EBITA	116.2	359.6	802.0	894.2	937.6
Goodwill (amort/impaird)	n/a	n/a	n/a	n/a	n/a
EBIT	116.2	359.6	802.0	894.2	937.6
Net interest	-105.6	-116.8	-99.9	-63.3	-35.3
Associates (pre-tax)	-733.5	145.0	173.8	191.9	201.2
Forex gain / (loss)	26.8	3.91	-5.86	-5.96	-5.98
Exceptionals (pre-tax)	n/a	170.0	n/a	n/a	n/a
Other pre-tax items	-145.8	33.4	-3.65	-25.2	-26.9
Reported PTP	-841.9	595.1	866.3	991.7	1071
Taxation	227.0	0.00	-190.6	-218.2	-235.6
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	595.1	675.7	773.5	835.2
Normalised Items Excl. GW	0.00	170.0	0.00	0.00	0.00
Normalised net profit	-614.8	425.1	675.7	773.5	835.2

Source: Company data, RBS forecasts

year to Dec

Balance sheet

Wb	FY09A	FY10A	FY11F	FY12F	FY13F
Cash & market secs (1)	80.4	109.0	563.8	741.1	1264
Other current assets	695.4	781.6	1019	1019	1028
Tangible fixed assets	1357	1423	1405	1407	1409
Intang assets (incl gw)	35.6	26.4	27.7	28.5	29.1
Oth non-curr assets	1032	1096	1060	1257	1464
Total assets	3200	3436	4076	4453	5194
Short term debt (2)	769.9	420.5	420.5	420.5	420.5
Trade & oth current liab	1289	1274	1038	641.4	714.7
Long term debt (3)	585.1	858.4	894.9	935.5	807.2
Oth non-current liab	20.9	2.07	2.07	2.07	2.07
Total liabilities	2665	2555	2356	1999	1944
Total equity (incl min)	535.1	880.3	1720	2454	3250
Total liab & sh equity	3200	3436	4076	4453	5194
Net debt	2150	1951	1215	674.4	92.2

Source: Company data, RBS forecasts

year ended Dec

Cash flow statement

Wb	FY09A	FY10A	FY11F	FY12F	FY13F
EBITDA	218.0	468.3	908.4	1001	1045
Change in working capital	-49.0	23.3	-155.4	6.57	-4.67
Net interest (pd) / rec	-105.6	-116.8	-99.9	-63.3	-35.3
Taxes paid	n/a	n/a	n/a	n/a	n/a
Other oper cash items	218.3	-121.5	-273.9	-249.2	-264.6
Cash flow from ops (1)	281.7	253.2	379.2	695.5	740.9
Capex (2)	-264.1	-174.9	-80.0	-100.0	-100.0
Disposals/(acquisitions)	-199.7	125.2	210.2	-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	115.5	-118.7	-119.1
Incr / (decr) in equity	0.00	0.00	200.0	0.00	0.00
Incr / (decr) in debt	129.3	-91.9	-220.1	-363.5	-59.5
Ordinary dividend paid	-17.3	0.00	-19.8	-36.0	-39.6
Preferred dividends (4)	n/a	n/a	n/a	n/a	n/a
Other financing cash flow	142.0	-78.9	0.00	0.00	0.00
Cash flow from fin (5)	253.9	-170.8	-39.9	-399.5	-99.1
Forex & disc ops (6)	n/a	n/a	n/a	n/a	n/a
Incr/(decr) cash (1+3+5+6)	67.3	29.6	454.8	177.3	522.7
Equity FCF (1+2+4)	17.6	78.3	299.2	595.5	640.9

Lines in bold can be derived from the immediately preceding lines.
Source: Company data, RBS forecasts

year to Dec

Standard ratios	Kumho Petrochem					Honam Petrochemical			LG Chem		
Performance	FY09A	FY10A	FY11F	FY12F	FY13F	FY11F	FY12F	FY13F	FY11F	FY12F	FY13F
Sales growth (%)	-12.0	38.7	39.2	3.02	1.10	25.8	5.61	10.5	24.8	10.5	11.2
EBITDA growth (%)	-38.3	114.8	94.0	10.2	4.39	35.8	8.02	1.41	30.1	9.10	11.5
EBIT growth (%)	-58.7	209.5	123.0	11.5	4.86	33.6	9.61	0.06	29.4	11.2	12.2
Normalised EPS growth (%)	3014	n/a	40.4	8.15	7.97	72.9	15.1	4.63	32.4	10.9	13.1
EBITDA margin (%)	7.78	12.1	16.8	18.0	18.6	16.6	17.0	15.6	18.8	18.6	18.6
EBIT margin (%)	4.15	9.25	14.8	16.0	16.6	13.4	13.9	12.5	15.1	15.2	15.3
Net profit margin (%)	-21.9	10.9	12.5	13.9	14.8	15.0	16.3	15.5	11.7	11.8	12.0
Return on avg assets (%)	-15.6	15.2	20.1	19.3	17.9	17.3	16.4	15.0	21.3	20.2	19.3
Return on avg equity (%)	-72.4	60.1	52.0	37.1	29.3	26.6	24.0	20.4	31.8	27.1	24.3
ROIC (%)	2.70	9.01	22.1	23.7	23.4	17.8	16.0	13.1	33.4	31.5	30.3
ROIC - WACC (%)	-8.38	-2.07	11.0	12.7	12.3	6.59	4.80	1.93	24.0	22.2	21.0
				year to Dec			year to Dec			year to Dec	
Valuation											
EV/sales (x)	2.43	1.70	1.08	0.96	0.84	1.41	1.33	1.19	1.29	1.12	0.97
EV/EBITDA (x)	31.2	14.1	6.46	5.32	4.54	8.46	7.79	7.64	6.85	6.04	5.19
EV/EBITDA @ tgt price (x)	36.7	16.7	7.78	6.51	5.68	10.2	9.38	9.21	7.94	7.04	6.09
EV/EBIT (x)	58.6	18.4	7.32	5.96	5.06	10.5	9.57	9.51	8.52	7.37	6.29
EV/invested capital (x)	2.51	2.33	2.00	1.70	1.42	1.97	1.61	1.34	3.10	2.55	2.09
Price/book value (x)	8.69	5.29	3.24	2.27	1.72	2.09	1.66	1.37	3.07	2.40	1.93
Equity FCF yield (%)	0.38	1.68	5.68	10.7	11.5	4.99	4.98	5.16	4.48	4.84	5.25
Normalised PE (x)	n/m	10.9	7.80	7.21	6.68	8.86	7.70	7.36	11.1	10.00	8.84
Norm PE @tgt price (x)	n/m	13.8	9.80	9.06	8.39	10.8	9.35	8.94	12.8	11.6	10.2
Dividend yield (%)	0.00	0.55	0.68	0.71	0.71	0.53	0.66	0.66	0.94	1.05	1.15
				year to Dec			year to Dec			year to Dec	
Per share data	FY09A	FY10A	FY11F	FY12F	FY13F	Solvency	FY09A	FY10A	FY11F	FY12F	FY13F
Tot adj dil sh, ave (b)	0.03	0.03	0.03	0.03	0.03	Net debt to equity (%)	401.8	221.6	70.6	27.5	2.84
Reported EPS (KRW)	-24183	23406	23474	25387	27411	Net debt to tot ass (%)	67.2	56.8	29.8	15.1	1.78
Normalised EPS (KRW)	-24183	16719	23474	25387	27411	Net debt to EBITDA	9.87	4.17	1.34	0.67	0.09
Dividend per share (KRW)	0	1000	1250	1300	1300	Current ratio (x)	0.38	0.53	1.08	1.66	2.02
Equity FCF per share (KRW)	691	3080	10393	19544	21035	Operating CF int cov (x)	3.67	3.17	4.80	12.0	22.0
Book value per sh (KRW)	21047	34625	56456	80544	106655	Dividend cover (x)	0.00	21.4	18.8	19.5	21.1
				year to Dec						year to Dec	

Priced as follows: 011780.KS - W183000; 011170.KS - W377000; 051910.KS - W477500
Source: Company data, RBS forecasts

Valuation methodology – Sum-of-the-parts valuation

Company	Business	Stake	Valuation methodology	(Wbn)
Main operation	Synthetic rubbers, synthetic resin	6x	EV/EBITDA	5,450
Other assets				
Kumho Polychem	EPM (Copolymer of ethylene and propylene), EPDM (Terpolymer of ethylene, propylene and a non-conjugated diene)	50%	5x 2011F EV/EBITDA reflecting narrow production scope	252
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Kumho Petro Holdings	Holding companies of five J/Vs in China	100%	Book value	71
Sub total				1,439
Treasury shares	22% of total shares		Based on W183,000 share price	1,023
Other assets	Assets related with Kumho Asiana group			334
Net debt				1,215
Equity value				7,032
No. of shares				30,467,693
Per share equity value (W)			Rounding from W230,802	230,000
Current share price (W)				183,000
Upside potentials				25.7%

Source: Company data, RBS forecasts

Company description

Buy

Price relative to country

Kumho Petrochem produces synthetic rubber (57% of total sales), synthetic resin (32%) and other specialty chemicals. Kumho enjoys 9-10% global synthetic rubber (eg BR, SBR) sales market share. Some 70% of synthetic rubber revenue comes from the tyre market, which shows solid demand. In the synthetic resin market, Kumho produces PS and ABS. In addition, the company has six chemical-related subsidiaries, including Kumho P&B, which produces phenol, bisphenol-A and epoxy resin. Kumho Petrochem was originally part of the Kumho Asiana group, but was spun off in early 2010 and recently began to focus on its core chemicals operation.



Strategic analysis

Average SWOT company score: 4

4

Sales Breakdown (FY11F)

Strengths

4

Kumho has a leading global position in synthetic rubbers, with 9-10% sales market share, and supplies its products to a diversified group of customers.

Weaknesses

3

Kumho is vulnerable to raw material price hikes, such as for butadiene and styrene monomer.

Opportunities

4

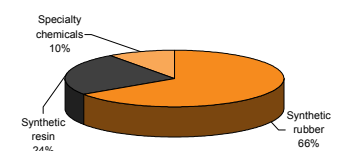
Kumho is likely to benefit from strong tyre demand, especially tyre replacement demand in China. High natural rubber prices also increase substitute demand for synthetic rubbers.

Threats

3

Ambitious expansion plans by Middle East and China producers over the next five to seven years might cause oversupply and lower profitability.

Scoring range is 1-5 (high score is good)



Source: RBS forecasts

Market data

Headquarters

115 Shinmunno 1-ga, Jongono-gu, Seoul, Korea

Website

www.kkpc.com

Shares in issue

25.4m

Freefloat

58%

Majority shareholders

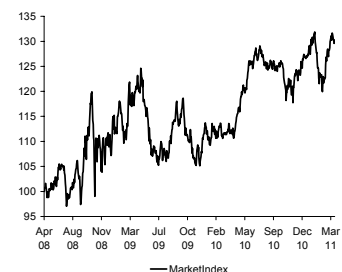
Related party (42%)

Country view: Korea

Country rel to Asia Pacific

The Korean market has experienced a relative bounce over the past quarter, effectively playing catch-up to regional share prices. Nonetheless, we remain concerned over gearing to the global manufacturing cycle, historically elevated valuations and relatively tight liquidity conditions. We concede, however, that with foreign investors, in general, Underweight, the market might continue to benefit from rotational buying.

The country view is set in consultation with the relevant company analyst but is the ultimate responsibility of the Strategy Team.



Competitive position

Average competitive score: 3-

3-

Broker recommendations

Supplier power

3-

The key raw material is butadiene, which is readily available. However, we are concerned about the declining self-sufficiency ratio of butadiene from 40% to 20%.

Barriers to entry

3+

Relatively high capital costs of US\$1bn and required economies of scale could be key barriers to new entrants.

Customer power

2-

Tyre makers are more dependent on synthetic rubber providers to catch up rapidly growing demand, as there are a few synthetic rubber suppliers.

Substitute products

4-

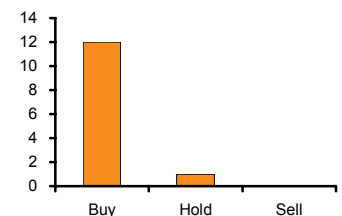
There are no substitutes for synthetic rubbers, even though natural rubbers can replace them to some degree. However, natural rubbers are more subject to tight supply.

Rivalry

2-

New capacity in China and the Middle East could pose a threat in the long term. However, we expect limited capacity addition in the near future.

Scoring range 1-5 (high score is good) Plus = getting better Minus = getting worse



Source: Bloomberg

Recommendation structure

Absolute performance, short term (trading) recommendation: A Trading Buy recommendation implies upside of 5% or more and a Trading Sell indicates downside of 5% or more. The trading recommendation time horizon is 0-60 days. For Australian coverage, 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 produced by Nedbank Capital, a Buy implies upside in excess of 20%, a Sell implies an expected return less than 10%, and a Hold implies a return between 10% and 20%. For UK-based Investment Funds research, the recommendation structure is not based on upside/downside to the target price. Rather it is the subjective view of the analyst based on an assessment of the resources and track record of the fund management company. For research produced by Nedbank Capital and 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.

Market or sector view: This view is the responsibility of the strategy team and a relative call on the performance of the market/sector relative to the region. Overweight/Underweight implies upside/downside of 10% or more and Neutral implies less than 10% upside/downside.

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.

Distribution of recommendations

The tables below show the distribution of recommendations (both long term and trading). The first column displays the distribution of recommendations globally and the second column shows the distribution for the region. Numbers in brackets show the percentage for each category where there is an investment banking relationship. These numbers include recommendations produced by third parties with which RBS has joint ventures or strategic alliances.

Long term recommendations (as at 14 Apr 2011)

	Global total (IB%)	Asia Pacific total (IB%)
Buy	787 (12)	510 (3)
Hold	421 (7)	224 (2)
Sell	106 (1)	57 (0)
Total (IB%)	1314 (10)	791 (2)

Source: RBS

Trading recommendations (as at 14 Apr 2011)

	Global total (IB%)	Asia Pacific total (IB%)
Trading Buy	1 (0)	1 (0)
Trading Sell	2 (0)	2 (0)
Total (IB%)	3 (0)	3 (0)

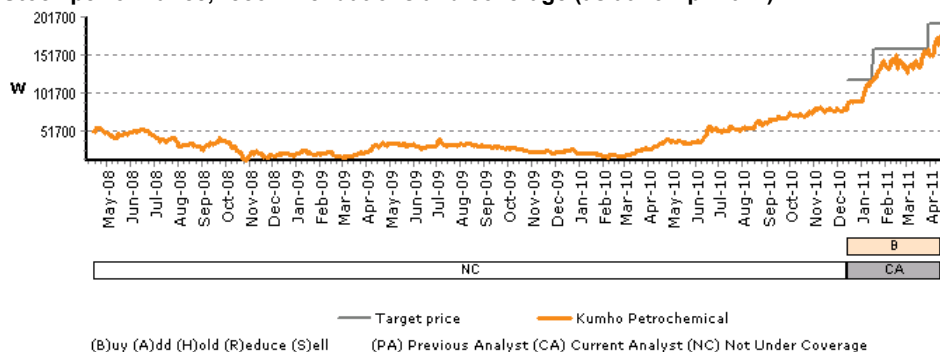
Source: RBS

Valuation and risks to target price

Kumho Petrochemical (RIC: 011780.KS, Rec: Buy, CP: W183000, TP: W230000): 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 Petrochemical coverage data

Stock performance, recommendations and coverage (as at 13 Apr 2011)



Trading recommendation history (as at 14 Apr 2011)

Date	Rec	Analyst
	n/a	

Source: RBS

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

Regulatory disclosures

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

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