Risk Management

Times of crisis have a way of separating healthy companies from the not-so-healthy ones. While every company experiences crises at one time or another, the important thing is how they respond and overcome them. At KKPC, our rigorous risk management system enables us to effectively prevent as well as actively respond to challenges when they arise.

Currency Risk

The Korean won continued to appreciate in 2011 until the second half of the year, when the downgrade of United States sovereign credit rating and worsening financial difficulties in the Eurozone started a downward trend, increasing volatility. In 2011, approximately 84% of total sales were in foreign currencies, including 67% from direct exports and 17% from local sales. About 89% of all overseas sales were in US dollars.

In 2012, we plan to take a long cash position of roughly USD 190 million based on our feedstock import requirements and foreign-denominated assets and liabilities. In this scenario, each KRW 10 change in the exchange rate will impact profitability by roughly KRW 1.9 billion. Our 2012 business plans and targets are based on an average exchange rate of KRW 1,050 to the US dollar. With the average rate holding above KRW 1,131 at the end of the first quarter of 2012, we expect the rate to have little or no impact on our ability to achieve our business targets.

Market Risk

The aftershock of the global financial crisis hit with full force in the second half of 2011. While China, India, and other emerging markets tightened their fiscal policies to dampen inflation, leading to slower growth, key developed markets like North America and Europe faced major financial crises, raising uncertainty to a higher level.

In the second half of 2012, emerging markets are expected to steadily recover, gradually lifting the global economy with them. On the other hand, there are a number of areas of concern. There is still considerable external risk due to the ongoing Eurozone financial crisis and the possibility of an oil shock due to political instability in the Middle East and Africa as well as fluctuation risk for both product pricing and profitability as raw materials prices rise. Our proactive response to these rapidly changing market conditions includes reallocating regional sales quotas and maintaining pricing flexibility.

Raw Materials Risk

An unprecedented jump in natural rubber prices sparked a sharp increase in demand for butadiene (BD), the key feedstock used to produce synthetic rubbers. This, combined with production issues in Taiwan and Singapore, pushed BD prices sharply higher through the first three quarters of the year. The worsening of the Eurozone financial crisis in the final quarter caused the overall global economy to contract, lowering demand and sending BD prices downward to close the year at around USD 1,700 per metric ton. In the first half of 2012, scheduled maintenance shutdowns by both Korean and other Asian producers are expected to tighten supply, pushing BD prices higher. The average BD price in 2012 is projected to be around USD 3,000 per metric ton.

As our synthetic rubbers production volume increases, BD supply is becoming an increasingly crucial issue. Over the short term, we are increasing sourcing from both domestic and international suppliers as well as seeking new suppliers to ensure our BD feedstock needs are met. Over the long term, we will continue to increase our BD self-supply ratio through a joint-venture BD plant in the Philippines as well as commercialization of new, more-efficient BD production processes.

Financial Risk

We dramatically reduced our debt-to-equity ratio from 361% at the end of 2010 to 203% at the end of 2011 as we paid off a portion of our long-term borrowings and convertible bonds were exercised. Growth in both sales and operating income translated into higher asset turnover and times interest earned ratios as our financial structure continued to steadily improve.

In 2012, we plan to use our operating cash flow to cut net borrowings to around KRW 1,400 billion, reducing our debt-to-equity ratio to under 170%. If necessary, we will gradually sell off equity stakes in affiliates such as Asiana Airlines and Daewoo Engineering & Construction that have been designated as investment securities. We plan to increase our investment plan to around KRW 400 billion as we invest in projects to expand the capacity of our SBR and SSBR plants and Yeosu Energy II as well as the bisphenol A plant of affiliate Kumho P&B Chemicals. Although we plan to increase investment to drive growth, we will efficiently execute our investment priorities to the extent that our operating cash flow allows as we step up management-by-objective to achieve our financial stability targets and wrap up our MOUs with creditor banks related to the company normalization plan as quickly as possible.