

Honam Petrochemical

BUY (maintain)

Fair value revised down

SABIC-Saudi Arabia, which has a direct impact on the domestic EG price of Honam Petrochemical, announced a Jun EG contract price for Asia of US\$550/ton, down 22.5% from US\$710/ton in May. The contract price falls substantially short of our expectations and thus we revise down our earnings forecast and fair value for Honam Petrochemical.

Reuters code	11170.KS
Bloomberg code	1117 KS
Current price (May 14)	W30,500
Fair value	W35,000
Market cap	US\$809.7mn
FY03F PER	3.4x
FY03F ROE	12.4%

Comment:

- ▶ SABIC, the second-largest global EG maker, announced that it cut the EG contract price for Jun by US\$160/ton from the May price to US\$550/ton before Dow Chemical made its Jun contract price public.
- ▶ The marked cut in SABIC's contract price seems to reflect weak spot prices from sluggish demand in China, which takes up 18.5% of global EG demand (2001). Southeast Asia EG spot prices tumbled to as low as US\$490/ton from the peak of US\$775/ton in mid-Mar.
- ▶ Such a plunge in Southeast Asia spot prices seems to be mostly attributable to the visible drop in the facility utilization ratios of Chinese polyester companies, as US and European buyers are extremely reluctant to purchase Chinese polyester products due to the spread of SARS in China. The average facility utilization ratio of Chinese polyester companies fell below 60% and, for some small companies, the rate plunged to as low as ~40%.
- ▶ Despite weak spot prices, we expected Jun contract prices to be US\$650/ton, considering 1) US natural gas prices still remain high and 2) the inventory level in China is low following lukewarm EG purchases since Feb. However, the actual contract price turned out to be US\$100/ton lower than our expectation.
- ▶ As such, we revise down the FY03F average EG-naphtha price spread from US\$380/ton to US\$365/ton, and OP and adjusted EPS by 6.6% and 6.8%, respectively. We also downgrade fair value by 10.3% from W39,000 to W35,000. The newly adjusted fair value is based on FY03F EV/EBITDA of 3.9x, applying a 15% discount to the manufacturing sector average EV/EBITDA of 4.6x.
- ▶ We maintain BUY on the counter in consideration of the following. First, the recent EG spot price drop is strongly affected by the temporary contraction of consumer sentiment in China from the SARS outbreak. Second, the price of ethylene, the raw material for EG, is nearing the historical bottom, which should limit any additional fall in the EG price. Third, the company is still undervalued, trading at EV/EBITDA of 3.4x, a 26.1% discount to the manufacturing sector average despite strong earnings momentum, as indicated by the expected 163.4%YoY jump in FY03F OP.

Revised FY03F earnings and major assumptions

(Wbn)	2002	Previous					2003F	Revised				
		1QF	2QF	3QF	4QF	1QF		2QF	3QF	4QF	2003F	
OR	1,229.7	378.7	344.0	331.4	347.2	1,401.3	378.7	340.4	329.0	346.0	1,390.9	
OP	54.4	39.0	42.1	37.0	35.3	153.4	39.0	38.2	37.3	28.7	143.3	
RP	69.4	45.1	48.6	42.8	40.8	177.3	45.1	45.5	43.5	32.9	167.0	
NP	59.5	31.7	34.2	30.1	28.7	124.6	31.7	32.0	30.6	23.1	117.4	
Adjusted EPS (W)	1,094	851	917	807	770	3,336	851	812	745	700	3,108	
(US\$/ton)												
Raw material/ product price	Naphtha	320	244	249	262	269	320	244	249	262	269	
	EG	613	710	620	650	648	613	680	600	640	633	
	PP	771	600	630	620	655	771	600	630	620	655	
	HDPE	645	539	560	550	573	645	539	560	550	573	
Spread	EG	293	466	371	388	380	293	436	351	378	365	
	PP	451	356	382	358	386	451	356	382	358	386	
	HDPE	325	295	311	288	305	325	295	311	288	305	

Source: Korea Petrochemical Industry Association, Hyundai Securities

Monthly EG price trend

(US\$/ton)	2002												2003						
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Avg.	Jan	Feb	Mar	Apr	May	Jun
Spot price	311	316	381	468	473	456	435	478	499	469	450	495	436	626	738	763	618	519	
Contract price																			
Dow Chemical	360	360	360	420	470	500	530	500	510	550	550	500	468	530	610	720	800	760	
SABIC	360	340	360	400	470	500	500	470	510	550	520	500	457	510	610	720	780	710	550
Spread																			
SABIC contract price-naphtha price	179	145	125	153	232	272	266	228	248	292	280	229	211	211	280	390	536	489	
Spot price-naphtha price	130	121	146	221	235	228	200	236	236	211	210	224	200	326	408	433	374	298	

Note: 1) Spot price is based on Southeast Asia C&F monthly average price. May spot price is the average for the first two weeks of the month.

2) Honam Petrochemical quotes SABIC's contract price for domestic sales.

Source: Company data, Korea Petrochemical Industry Association

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Recommendation

Company recommendations refer to anticipated share performance relative to the market for a maximum of six months.

Strong BUY: 30% or better relative outperformance for over six months.

BUY: 10-30% relative outperformance for over six months.

Trading BUY: 10-30% relative outperformance for over two months.

Marketperform: 10% relative outperformance to 10% relative underperformance for over six months.

Underperform: 10% or worse relative underperformance for over six months.

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