

# Steel/non-ferrous metal 2Q preview

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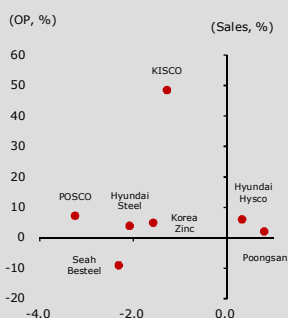
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## KOREA Steel

Stock	Rating	TP (W)
POSCO	BUY	490,000
Hyundai Steel	BUY	130,000
Dongkuk Steel	HOLD	-
Hyundai Hysco	BUY	49,000
Seah Besteel	BUY	55,000
KISCO	BUY	32,000
Korea Zinc	BUY	460,000
Poongsan	BUY	36,000

### Consensus vs TY estimate



Source: TONGYANG Securities

## 2H outlook positive

### Large plays to meet or even beat consensus

- The outlook for steelmakers' 2Q results is favorable. Although earnings are likely to decline y-y, most steelmakers should meet or even beat consensus, as sharply declining earnings in 1Q had dampened expectations. In particular, large steel/non-ferrous metal plays are expected to meet expectations.
- We believe POSCO and Hyundai Steel's operating profit declined by an average of 24% y-y, but rose 131% q-q (POSCO's 148% q-q to W1,047.9bn; Hyundai Steel's 115% q-q to W336.2bn). The two will likely beat market consensus (POSCO W977.5bn, Hyundai Steel W323.7bn).
- Despite lower automotive steel prices, Hyundai Hysco's OP should rise 19% q-q to W106.7bn, with OPM at 5%, as continuous galvanizing line (CGL) capacity additions in Dangjin (number-two plant, 250,000 tpa) in Sep 2011 and Suncheon (300,000 tpa) in Jan 2012 boosted shipments (CR +15% q-q).
- Meanwhile, despite weaker commodity prices, non-ferrous metal earnings should be solid thanks to a stronger dollar amid the eurozone crisis. We believe Korea Zinc's OP increased 24% q-q to W249.2bn on larger gold sales.

### Dom prices falling; China's retail prices to recover → market conditions to improve in 4Q

- We maintain NEUTRAL on the sector, but expect market conditions to be stronger in 2H vs 1H. Steel prices are expected to rebound in August, at the earliest, or in 4Q, at the latest.
- Retail prices should recover soon on a series of interest rate cuts in China. Retailers are likely to build up inventory in August ahead of strong seasonality in autumn. Moreover, retailers' HR inventory is now at its lowest since 2010, a sign that de-stocking is almost complete. Expectations for the Chinese government's infrastructure investment ahead of the leadership change in October also reinforce our view that prices will rise in 3Q.
- Meanwhile, domestic HR prices fell from mid-June and are expected to keep falling into 3Q, which could lead to concerns over 3Q earnings. It is too early for steel shares to get a boost, but we think they could show positive signals in the seasonally strong 3Q, given that Chinese retail prices tend to precede share movements. Presently, we see steel shares as defensive plays, but expect them to become more aggressive picks in 3Q. We maintain POSCO and Korea Zinc as top picks, but could shift to Hyundai Steel and Poongsan upon favorable changes in China.

## I. 2Q earnings season favorable for steel shares

### Large plays to meet consensus

The outlook for 2Q results is favorable for steelmakers. Although earnings are likely to fall y-y, most steelmakers should meet or even beat consensus, as sharply declining earnings in 1Q had dampened expectations. In particular, large steel/non-ferrous metal plays are expected to meet expectations.

We believe POSCO and Hyundai Steel's operating profit dropped an average of 24% y-y, but rose 131% q-q (POSCO's 148% q-q to W1,047.9bn; Hyundai Steel's 115% q-q to W336.2bn). The two will likely beat market consensus (POSCO W977.5bn, Hyundai Steel W323.7bn).

### Blast furnace earnings improve on lower raw material prices

We attribute improved results at blast furnace firms like POSCO and Hyundai Steel to the input of raw materials bought at low prices in 1Q, rather than better market conditions. In other words, higher operating margin came from lower raw material prices, not higher ASP. In addition, despite lower automotive steel prices, Hyundai Hysco's operating profit likely rose 19% q-q to W106.7bn, with operating margin at 5%, as CGL capacity additions in Dangjin (number-two plant, 250,000 tpa) in Sep 2011 and Suncheon (300,000 tpa) in Jan 2012 boosted shipments (CR +15% q-q).

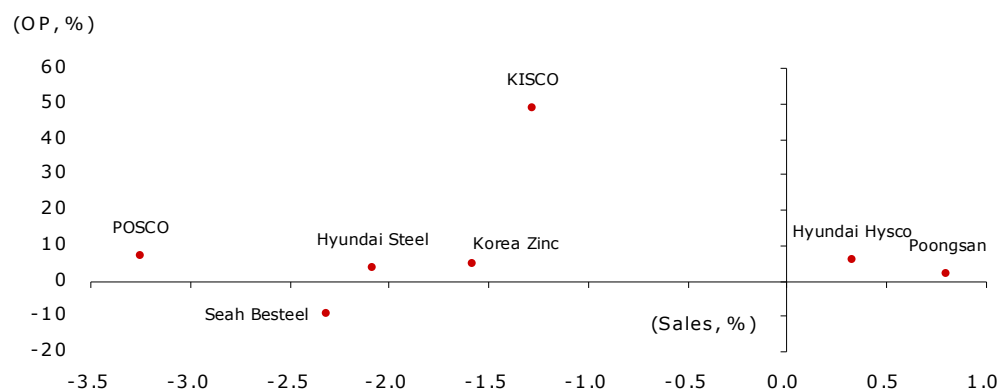
### Seah to report weaker-than-expected OP on lower-than-expected special steel shipment, truckers' strike

However, Seah Besteel's operating profit is likely to disappoint. Although operating profit was originally expected to reach the high-W70bn level, we believe it came to just W63.4bn, as softening auto demand reduced shipments. Special steel shipments came to only 500,000 tonnes, below initial expectations of 530,000~540,000 tonnes, due to lower demand from carmakers and a truck drivers' strike.

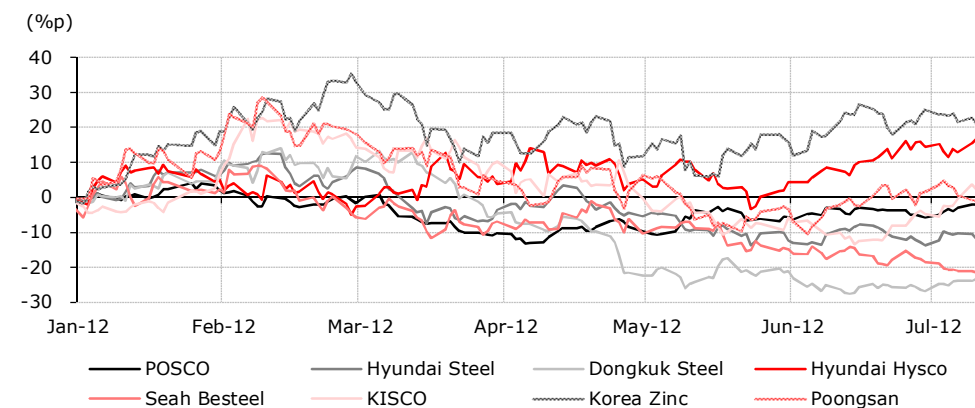
### Korea Zinc's OP to rise on gold inventory disposal

Meanwhile, despite weaker commodity prices, non-ferrous metal plays should post solid earnings, as the dollar has strengthened amid the eurozone crisis. We believe Korea Zinc's operating profit increased 24% q-q to W249.2bn on larger gold sales.

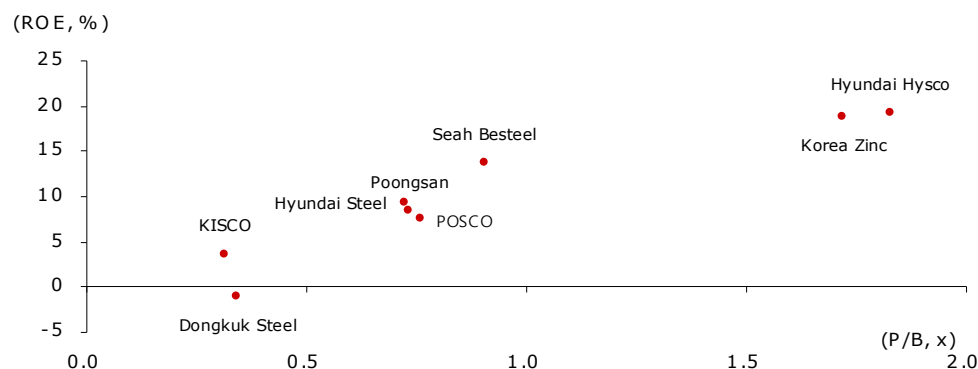
We expect Dongkuk Steel to post operating profit of W2.3bn on strength in long products (rebar operating margin 3.5%, beam 8.5%), despite plate operating margin remaining in negative territory (-5%) and forex losses. KISCO should see operating profit improve to W20.1bn.

**[Chart 1] Steel/non-ferrous metal plays: TY sales and OP forecast vs consensus**

Source: TONGYANG Securities

**[Chart 2] Steel/non-ferrous metal plays' performance relative to KOSPI**

Source: TONGYANG Securities

**[Chart 3] Steel/non-ferrous metal plays' 2012E P/B and ROE**

Source: TONGYANG Securities

**[Table 1-1] Steel/non-ferrous metal universe: earnings forecast**

	Year	Sales (Wbn)	(q-q) (%)	(y-y) (%)	OP (Wbn)	(q-q) (%)	(y-y) (%)	OPM (%)	Pre-tax P (Wbn)	NP (Wbn)	EPS (won)	(y-y) (%)	BPS (won)	P/E (x)	P/B (x)	ROE (%)
POSCO	2011	39,172	-	-	4,196	-	-	10.7	4,066	3,189	36,575	-	458,664	11.9	0.9	8.7
	2012E	37,027	-	-5.5	3,324	-	-20.8	9.0	3,659	2,898	33,234	-9.1	486,311	11.1	0.8	7.5
	2013E	38,644	-	4.4	3,747	-	12.7	9.7	3,941	3,121	35,798	7.7	513,840	10.3	0.7	7.6
BUY	1Q11	9,112	-0.7	31.1	921	77.6	-36.1	10.1	1,174	927						
	2Q11	10,032	10.1	26.5	1,496	62.4	-16.8	14.9	1,642	1,246						
TP: W490,000	3Q11	9,961	-0.7	16.9	1,087	-27.4	5.9	10.9	255	249						
	4Q11	10,066	1.1	9.7	692	-36.3	33.5	6.9	993	767						
	1Q12	9,460	-6.0	3.8	422	-39.0	-54.2	4.5	680	539						
	<b>2Q12E</b>	<b>9,236</b>	<b>-2.4</b>	<b>-7.9</b>	<b>1,048</b>	<b>148.2</b>	<b>-30.0</b>	<b>11.3</b>	<b>865</b>	<b>685</b>						
	(Consensus)	9,546	0.9	-4.8	978	131.6	-34.7	10.2	924	740						
	3Q12E	9,026	-2.3	-9.4	914	-12.8	-15.9	10.1	1,066	845						
	(Consensus)	9,305	-2.5	-6.6	958	-2.0	-11.8	10.3	1,053	813						
	4Q12E	9,305	3.1	-7.6	940	2.8	35.7	10.1	1,048	830						
Hyundai Steel	2011	15,260	-	-	1,307	-	-	8.6	894	735	8,618	-	106,743	13.8	1.1	8.4
	2012E	14,554	-	-4.6	1,086	-	-16.9	7.5	1,050	892	10,459	21.4	116,505	8.1	0.7	9.4
	2013E	15,099	-	3.7	1,187	-	9.3	7.9	1,006	855	10,022	-4.2	126,033	8.4	0.7	8.3
BUY	1Q11	3,547	23.6	75.8	309	-13.6	137.1	8.7	330	258						
	2Q11	4,052	14.2	48.9	409	32.2	11.7	10.1	416	334						
TP: W130,000	3Q11	3,757	-7.3	45.0	287	-29.8	43.7	7.6	-180	-127						
	4Q11	3,904	3.9	36.0	301	5.0	-15.8	7.7	328	270						
	1Q12	3,550	-9.1	0.1	157	-48.0	-49.4	4.4	185	158						
	<b>2Q12E</b>	<b>3,771</b>	<b>6.2</b>	<b>-6.9</b>	<b>336</b>	<b>114.7</b>	<b>-17.8</b>	<b>8.9</b>	<b>204</b>	<b>173</b>						
	(Consensus)	3,851	8.5	-5.0	324	106.7	-20.9	8.4	265	215						
	3Q12E	3,412	-9.5	-9.2	270	-19.7	-5.9	7.9	334	284						
	(Consensus)	3,647	-5.3	-2.9	294	-9.0	2.6	8.1	298	248						
	4Q12E	3,820	11.9	-2.2	323	19.7	7.2	8.5	327	278						
Dongkuk Steel	2011	5,909	-	-	182	-	-	3.1	63	11	177	-	46,255	188.6	0.7	0.4
	2012E	5,343	-	-9.6	-1	-	TTR	-	-45	-30	-489	TTR	45,358	-31.6	0.3	-1.1
	2013E	5,609	-	5.0	95	-	TTB	1.7	1	2	34	TTB	44,985	459.0	0.3	0.1
HOLD	1Q11	1,467	-4.4	38.0	126	1,822.2	20.2	8.6	133	102						
	2Q11	1,576	7.4	21.4	143	13.8	212.6	9.1	141	108						
TP: -	3Q11	1,326	-15.9	-3.6	-81	TTR	TTR	-	-202	-183						
	4Q11	1,540	16.2	0.4	-6	C	TTR	-	-9	-16						
	1Q12	1,385	-10.1	-5.6	-38	RR	TTR	-	-56	-46						
	<b>2Q12E</b>	<b>1,393</b>	<b>0.6</b>	<b>-11.6</b>	<b>2</b>	<b>TTB</b>	<b>-98.4</b>	<b>0.2</b>	<b>-13</b>	<b>-13</b>						
	(Consensus)	1,431	3.4	-9.2	1	TTB	-99.4	0.1	-15	-17						
	3Q12E	1,196	-14.1	-9.8	6	182.7	TTB	0.5	5	6						
	(Consensus)	1,305	-8.8	-1.6	19	2,017.2	TTB	1.5	21	17						
	4Q12E	1,369	14.4	-11.1	28	340.0	TTB	2.1	19	23						

Note: IFRS non-consolidated; consensus based on Fnguide; TTR = turn to red, TTB turn to black, RR remain in red

Source: TONGYANG Securities

[Table 1-2] Steel/non-ferrous metal universe: earnings forecast

	Year	Sales (Wbn)	(q-q) (%)	(y-y) (%)	OP (Wbn)	(q-q) (%)	(y-y) (%)	OPM (%)	Pre-tax P (Wbn)	NP (Wbn)	EPS (won)	(y-y) (%)	BPS (won)	P/E (x)	P/B (x)	ROE (%)
	2011	6,935	-	-	346	-	-	5.0	319	255	3,185	-	19,160	12.7	2.1	18.1
	2012E	7,389	-	6.5	399	-	15.4	5.4	389	326	4,062	27.5	22,973	10.3	1.8	19.4
Hyundai Hysco	2013E	8,107	-	9.7	441	-	10.5	5.4	426	357	4,447	9.5	27,172	9.4	1.5	17.8
	1Q11	1,557	-3.0	27.2	79	192.4	22.2	5.1	71	57						
BUY	2Q11	1,772	13.8	18.8	108	37.0	37.4	6.1	102	80						
	3Q11	1,739	-1.9	13.8	70	-35.0	6.4	4.0	67	55						
TP: W49,000	4Q11	1,868	7.5	16.4	89	27.2	231.4	4.8	79	64						
	1Q12	1,758	-5.9	12.9	90	0.7	14.1	5.1	87	73						
	<b>2Q12E</b>	<b>1,929</b>	<b>9.8</b>	<b>8.9</b>	<b>107</b>	<b>18.8</b>	<b>-1.1</b>	<b>5.5</b>	<b>104</b>	<b>87</b>						
	(Consensus)	1,923	9.4	8.5	101	12.2	-6.6	5.2	100	79						
	3Q12E	1,785	-7.5	2.7	97	-9.4	37.8	5.4	95	79						
	(Consensus)	1,793	-6.8	3.1	86	-14.6	22.7	4.8	82	66						
	4Q12E	1,917	7.4	2.6	106	9.6	18.7	5.5	103	86						
	2011	2,485	-	-	297	-	-	12.0	271	227	6,317	-	35,916	8.5	1.5	18.9
	2012E	2,653	-	6.8	258	-	-13.3	9.7	240	186	5,185	-17.9	39,713	6.9	0.9	13.7
Seah Besteel	2013E	2,838	-	7.0	310	-	20.2	10.9	291	225	6,285	21.2	44,609	5.7	0.8	14.9
	1Q11	606	19.2	48.2	74	31.1	111.3	12.3	69	60						
BUY	2Q11	674	11.3	34.8	96	29.0	47.1	14.2	90	76						
	3Q11	607	-9.9	34.8	66	-31.4	26.8	10.8	56	47						
TP: W55,000	4Q11	597	-1.6	17.5	61	-6.9	8.1	10.3	57	44						
	1Q12	644	7.8	6.2	62	0.4	-17.2	9.6	58	44						
	<b>2Q12E</b>	<b>641</b>	<b>-0.4</b>	<b>-4.9</b>	<b>63</b>	<b>3.0</b>	<b>-33.9</b>	<b>9.9</b>	<b>59</b>	<b>46</b>						
	(Consensus)	656	1.9	-2.7	70	13.3	-27.3	10.6	65	53						
	3Q12E	638	-0.5	5.0	61	-3.9	-7.4	9.6	56	44						
	(Consensus)	620	-5.5	2.1	63	-9.8	-4.4	10.1	59	47						
	4Q12E	730	14.5	22.2	72	17.9	17.3	9.8	67	52						
	2011	1,021	-	-	-43	-	-	-	-42	-34	-3,638	-	73,201	-8.0	0.4	-4.8
	2012E	984	-	-3.6	26	-	TTB	2.6	31	25	2,706	TTB	75,303	8.8	0.3	3.6
KISCO	2013E	1,029	-	4.5	53	-	105.9	5.2	56	45	4,901	81.1	79,339	4.8	0.3	6.3
	1Q11	202	-17.1	-2.3	7	-78.2	-40.1	3.7	9	6						
BUY	2Q11	280	38.9	28.2	9	19.3	-44.2	3.2	10	8						
	3Q11	213	-23.9	1.0	-14	TTR	RR	-	-19	-14						
TP: W32,000	4Q11	283	32.6	16.3	-43	RR	TTR	-	-40	-33						
	1Q12	241	-14.7	19.6	-21	RR	TTR	-	-18	-14						
	<b>2Q12E</b>	<b>264</b>	<b>9.3</b>	<b>-5.9</b>	<b>20</b>	<b>TTB</b>	<b>125.7</b>	<b>7.6</b>	<b>21</b>	<b>17</b>						
	(Consensus)	267	10.7	-4.6	14	TTB	52.0	5.1	12	9						
	3Q12E	217	-17.9	1.5	11	-44.6	TTB	5.1	12	9						
	(Consensus)	224	-16.3	4.9	10	-25.5	TTB	4.5	9	8						
	4Q12E	262	21.0	-7.3	16	42.9	TTB	6.1	17	13						

Note: IFRS non-consolidated; consensus based on Fnguide; TTR = turn to red, TTB turn to black, RR remain in red  
Source: TONGYANG Securities

**[Table 1-3] Steel/non-ferrous metal universe: earnings forecast**

	Year	Sales (Wbn)	(q-q) (%)	(y-y) (%)	OP (Wbn)	(q-q) (%)	(y-y) (%)	OPM (%)	Pre-tax P (Wbn)	NP (Wbn)	EPS (won)	(y-y) (%)	BPS (won)	P/E (x)	P/B (x)	ROE (%)
	2011	4,858	-	-	879	-	-	18.1	890	677	35,866	-	177,321	10.3	2.1	22.7
	2012E	4,683	-	-3.6	865	-	-1.6	18.5	902	684	36,269	1.1	211,728	10.0	1.7	18.8
Korea Zinc	2013E	5,084	-	8.6	930	-	7.5	18.3	978	742	39,348	8.5	249,214	9.2	1.5	17.2
	1Q11	1,048	28.0	30.9	209	46.2	23.0	20.0	227	173						
BUY	2Q11	1,325	26.4	65.3	196	-6.3	10.5	14.8	205	158						
	3Q11	1,350	1.8	91.0	263	34.1	112.6	19.5	234	178						
TP: W460,000	4Q11	1,134	-16.0	38.4	210	-20.1	46.8	18.5	224	168						
	1Q12	1,213	7.0	15.7	200	-4.7	-4.3	16.5	215	163						
	<b>2Q12E</b>	<b>1,276</b>	<b>5.2</b>	<b>-3.7</b>	<b>249</b>	<b>24.4</b>	<b>27.0</b>	<b>19.5</b>	<b>256</b>	<b>194</b>						
	(Consensus)	1,296	6.9	-2.2	238	18.6	21.1	18.3	249	187						
	3Q12E	1,054	-17.4	-21.9	197	-20.9	-25.1	18.7	205	155						
	(Consensus)	1,185	-8.6	-12.2	215	-9.5	-18.3	18.2	224	170						
	4Q12E	1,139	8.1	0.5	218	10.8	3.9	19.2	227	172						
	2011	2,294	-	-	139	-	-	6.1	98	72	2,570	-	33,816	14.9	1.1	7.8
	2012E	2,397	-	4.5	159	-	14.3	6.6	117	84	2,997	16.6	36,419	8.9	0.7	8.5
Poongsan	2013E	2,620	-	9.3	160	-	0.8	6.1	118	84	3,010	0.4	39,036	8.9	0.7	8.0
	1Q11	552	-4.7	6.1	62	205.2	-17.6	11.3	53	35						
BUY	2Q11	604	9.4	9.8	29	-52.8	-15.9	4.9	19	20						
	3Q11	540	-10.7	0.7	26	-10.3	-59.9	4.9	17	14						
TP: W36,000	4Q11	597	10.6	3.1	21	-21.0	2.2	3.5	9	3						
	1Q12	534	-10.6	-3.3	31	50.2	-49.7	5.9	21	15						
	<b>2Q12E</b>	<b>622</b>	<b>16.4</b>	<b>2.9</b>	<b>39</b>	<b>23.4</b>	<b>31.4</b>	<b>6.2</b>	<b>28</b>	<b>20</b>						
	(Consensus)	617	15.5	2.1	38	21.0	28.8	6.1	26	20						
	3Q12E	527	-15.2	-2.4	37	-3.9	40.8	7.0	27	19						
	(Consensus)	585	-5.1	8.4	37	-1.5	41.5	6.4	27	20						
	4Q12E	714	35.5	19.6	52	39.3	148.2	7.2	41	30						

Note: IFRS non-consolidated; consensus based on Fnguide; TTR = turn to red, TTb turn to black, RR remain in red

Source: TONGYANG Securities

### **Blast furnace margin growth strong on lower material input cost**

Blast furnace steel plays' likely saw substantial margin growth in 2Q thanks to the following:

- 1) 2Q material input cost likely fell over W55,000/tonne q-q, vs our previous forecast of W40,000/tonne, as lower-priced materials (down US\$63/tonne q-q), including iron ore and bituminous coal, were used in 2Q.
- 2) Export margins improved, as the won weakened vs the dollar from May. Of note, POSCO, whose exports make up 40% of total sales, benefited strongly from a weakening won, as did Hyundai Steel, whose exports account for 25%.
- 3) Unlike in 1Q, domestic ASPs remained intact, despite downward pricing pressure.

As such, we believe POSCO's 2Q operating profit rose 148% q-q to W1.04tn (-30% y-y), returning to the W1tn level for the first time in a year. Despite continued rebar ASP cuts, Hyundai's 2Q operating profit should surge 115% q-q to W336.2bn thanks to solid shipments for long products on seasonality and steel scrap price decreases.

### **3Q headwinds: downward price pressure despite lower input cost**

However, in 3Q, we believe blast furnace steel manufacturers' profits will inevitably suffer q-q for the following reasons:

First, although 2Q material contract price (to be used for 3Q) fell US\$40/tonne q-q, 3Q material input cost is likely to fall just W20,000/tonne q-q, as the won weakened sharply against the US dollar in 2Q. Second, with China's steel retail price skidding US\$30~40/tonne from its peak during 2Q, we expect Korean blast furnace steel makers' export prices to suffer about US\$30/tonne. Third, blast furnace steel plays resisted downward pricing pressure in 2Q, due to sharp margin squeeze in 1Q. However, in 3Q, they are likely to be forced to trim domestic ASPs, as the domestic downstream industry's recovery is delayed and the price gap between domestic products and low-priced imports has widened further.

With 3Q material input cost expected to fall about W20,000/tonne q-q, blast furnace steel plays will be able to sustain margins if ASP cuts do not exceed W20,000/tonne. We estimate that flat-product ASP will decline about W33,000/tonne. As such, we think that in 3Q blast furnace steel plays' profits will inevitably suffer q-q.

In 3Q, Hyundai Steel's operating profit is expected to drop sharply, as it will likely cut long-product utilization by 20~30% on seasonality, and the government will ask steel makers to reduce electricity use. However, long-product profits could recover strongly from September, as: 1) long-product supply shortage seems likely from mid-August on production cuts; and 2) steel scrap prices should fall and stabilize in 3Q.

POSCO's 3Q operating profit is likely to drop 13% q-q to W914.3bn and Hyundai Steel's 20% q-q to W270.0bn.

## 2Q: Hyundai Hysco results in-line; Seah weaker than expected

For 2Q, we expect mixed results for Hyundai Hysco and Seah Besteel, which both have a high portion of auto steel products, for which demand is relatively stable.

We believe Hyundai Hysco's 2Q operating profit jumped 19% q-q to W106.7bn, in line with consensus. Despite a W70,000/tonne price cut for auto steel sheets, we believe Hysco reduced its fixed-cost burden, and thus, sustained stable margins on increased shipments, as newly-added CGAL lines in Dangjin and Suncheon began operating. In 3Q, operating profit is estimated at W96.6bn, below the 2Q level, but still stable, as operating margin should remain stable at 5% (steel pipe operating margin should improve to about 3% and roll margin should hold steady).

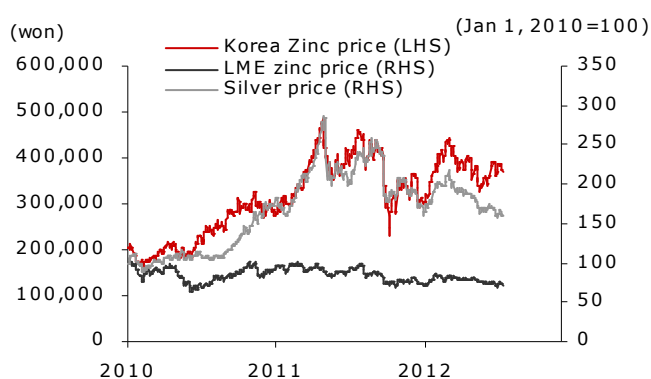
By contrast, Seah Besteel's 2Q operating profit likely missed consensus, as steel bar shipments dwindled from May. We believe operating profit rose 3% q-q (-43% y-y) to W63.4bn (vs our previous forecast of W70.0bn) as monthly shipments likely dropped from an average of 180,000 tonnes in 1Q to 170,000 in May and 150,000 in June due to strikes. In 3Q, we expect operating profit to decline 4% q-q to W61.0bn.

## Korea Zinc and Poongsan operating profit likely rose q-q

Although the price of key non-ferrous metals decreased over March~May, we expect Korea Zinc and Poongsan to report solid earnings for 2Q. Although Korea Zinc's lead, gold, and silver ASP dipped 2% vs 1Q, but 2Q results should beat expectations, with operating profit likely to rise 24% q-q to W249.2bn. This is solely driven by growth in gold inventory sales. Indeed, gold shipments grew from 540kg in 4Q11 and 862kg in 1Q12 to 1.55 tonnes in 2Q (2012 guidance is 1 tonne per quarter).

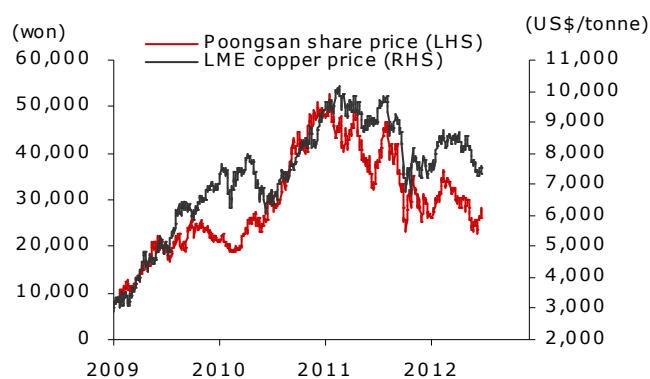
Previously, Poongsan's earnings outlook was grim as the price of LME copper plunged from US\$8,471/tonne in March to US\$7,283 in June. However, we believe Poongsan's operating profit increased 23% q-q to W38.6bn.

LME zinc and silver price vs Korea zinc's share price



Source: TONGYANG Securities

LME copper price vs Poongsan's share price



Source: TONGYANG Securities



### Downgrade Dongkuk to HOLD; revise down Seah's TP to W55k

We downgrade Dongkuk Steel from BUY to HOLD on, as its plate business outlook is still uncertain, and its earnings are largely determined by volatile forex movements at present. We do not think its attractive valuation (0.3x P/B) alone is enough to justify a BUY rating for now. We expect losses at the plate division to continue into 3Q, as plate prices are expected to come under pressure from shipbuilders.

For Seah Besteel, while we maintain BUY, we revise down our target price 20% from W68,000 to W55,000. Its shipments started decreasing from May (monthly shipments normally average 180,000 tonnes), and we do not expect to see upside momentum for shares until 3Q. Our new target price is based on a three-year average P/B of 1.4x.

#### Change in ratings and target prices

	Rating		Target price		Grounds
	Previous	Revised	Previous	Revised	
Dongkuk	BUY	HOLD	28,600	-	Plate weakness
Seah Besteel	BUY	BUY	68,000	55,000	Monthly shipments down; likely weak 2Q results

Source: TONGYANG Securities

**Domestic prices falling; China's retail prices to recover → market conditions to improve in 4Q**

We maintain NEUTRAL on the sector, but expect market conditions to improve in 2H vs 1H. As steel prices should rebound in August at the earliest, or in 4Q at the latest, we may shift our rating to OVERWEIGHT. However, given systemic overcapacity in East Asia, the steel market cycle is expected to last only three~six months.

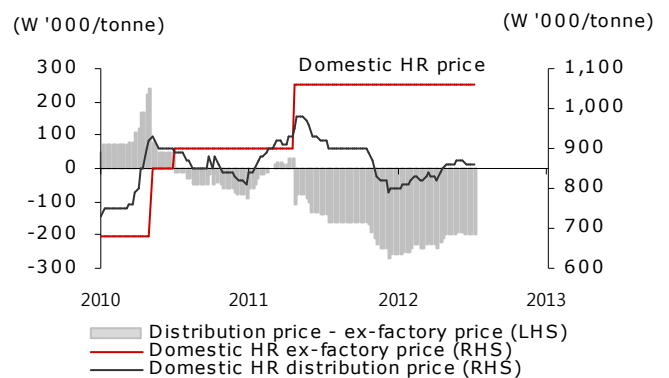
After a rate cut on Jun 7, last week China lowered its benchmark interest rate, earlier than expected, driving down the loan rate to 6%. After the Lehman bankruptcy, when loan rates fell below 6%, retail prices rebounded. Thus, retailers may start restocking in August ahead of the strong fall season. In addition, retailers' HR inventories are now at their lowest since 2010 and inventory relative to production is even lower, signaling that de-stocking is coming to an end. Lastly, expectations for the Chinese government's infrastructure investment ahead of the leadership change in October cement our view that prices will rise in 3Q.

**[Chart-18] Loan rate and HR distribution price in China**



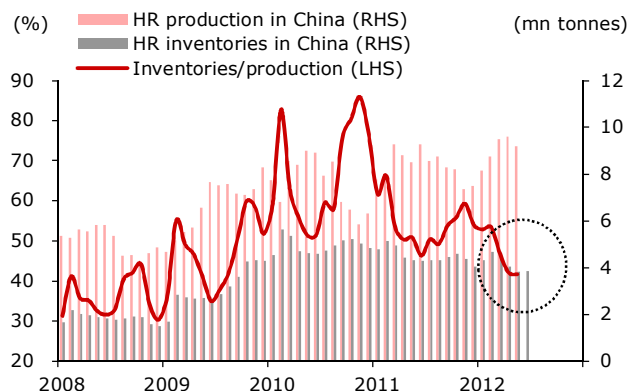
Source: TONGYANG Securities

**[Chart-19] HR distribution price in Korea**



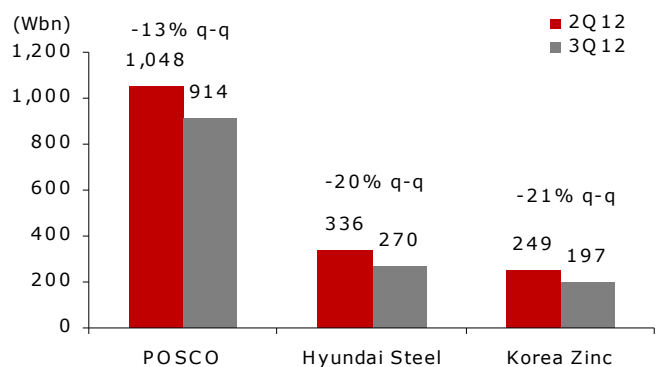
Source: TONGYANG Securities

**[Chart-20] HR inventories vs production in China**



Source: CEIC, Mysteel, TONGYANG Securities

**[Chart-21] POSCO, Hyundai, Korea Zinc: OP estimates**

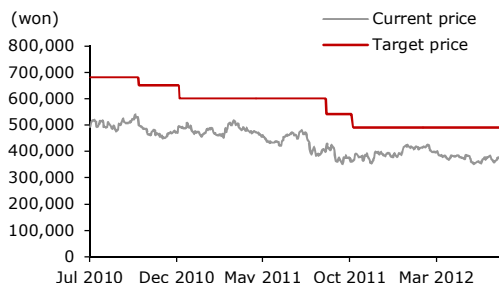


Source: TONGYANG Securities

While there are high expectations for a price rebound in China, domestic HR prices began to decline in mid-June and are expected to continue falling into 3Q, which could lead to concerns over 3Q results. Domestic HR prices are falling due to: 1) weak seasonality; and 2) offer prices falling significantly after retail HR prices in China, a leading indicator, fell by more than US\$30/tonne vs the high. HR offer price recently fell from US\$650/tonne to US\$590 and is forecast to remain at the US\$500 level. Export prices will likely fall by US\$40/tonne and domestic price is also expected to drop by W20,000/tonne (especially heavy plates for shipbuilding). Thus, domestic blast furnace firms, which saw improved earnings in 2Q, as well as electric furnace plays are likely to see earnings decline in 3Q vs 2Q.

Although it is too early for steel shares to get a boost, we think they could show positive signals in seasonally strong fall, as Chinese retail prices tend to precede share movements. Presently, we see steel shares as defensive plays, but expect them to become more aggressive picks in fall on seasonality. We maintain POSCO and Korea Zinc as top picks, but could shift to Hyundai Steel and Poongsan upon favorable changes in China.

## POSCO ratings and target price history



Date	Rating	TP (won)
2012/04/10	BUY	490,000
2012/03/12	BUY	490,000
2012/01/10	BUY	490,000
2011/11/23	BUY	490,000
2011/10/24	BUY	490,000
2011/10/13	BUY	540,000
2011/10/05	BUY	540,000
2011/09/07	BUY	540,000
2011/07/25	BUY	600,000
2011/07/07	BUY	600,000

Source: TONGYANG Securities

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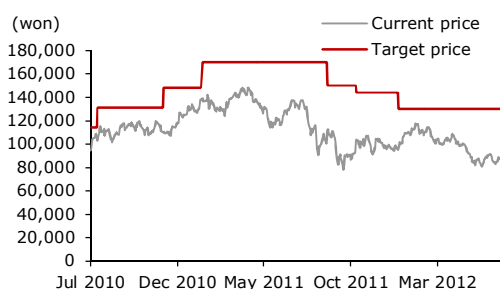
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## Hyundai Steel ratings and target price history



Date	Rating	TP (won)
2012/04/10	BUY	130,000
2012/03/12	BUY	130,000
2012/01/10	BUY	130,000
2011/11/23	BUY	144,000
2011/10/28	BUY	144,000
2011/10/13	BUY	150,000
2011/09/07	BUY	150,000
2011/07/29	BUY	170,000
2011/07/07	BUY	170,000
2011/06/02	BUY	170,000

Source: TONGYANG Securities

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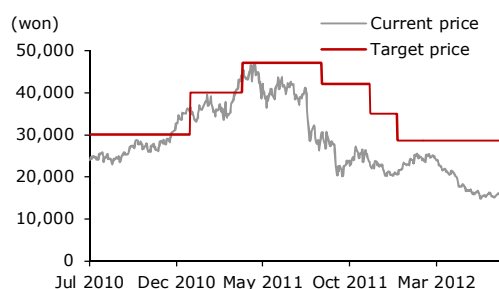
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## Dongkuk Steel ratings and target price history



Date	Rating	TP (won)
2012/07/12	HOLD	-
2012/04/10	BUY	28,600
2012/01/10	BUY	28,600
2011/11/23	BUY	35,000
2011/10/13	BUY	42,000
2011/08/30	BUY	42,000
2011/07/07	BUY	47,000
2011/06/02	BUY	47,000
2011/04/13	BUY	47,000
2011/03/09	BUY	40,000

Source: TONGYANG Securities

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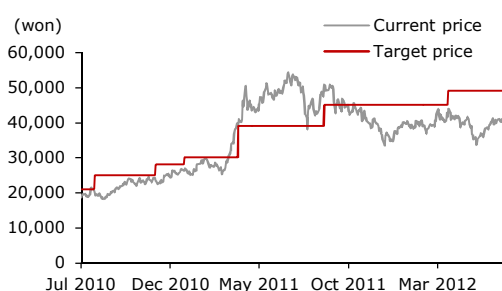
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## Hyundai Hysco ratings and target price history



Date	Rating	TP (won)
2012/04/10	BUY	49,000
2012/04/05	BUY	49,000
2012/01/10	BUY	45,000
2011/11/23	HOLD	45,000
2011/10/13	HOLD	45,000
2011/09/07	HOLD	45,000
2011/07/07	HOLD	39,000
2011/06/02	HOLD	39,000
2011/04/13	HOLD	39,000
2011/03/09	BUY	30,000

Source: TONGYANG Securities

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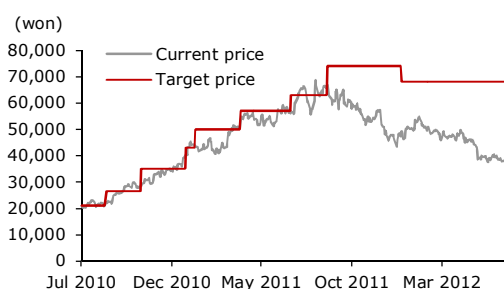
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## Seah Besteel ratings and target price history



Date	Rating	TP (won)
2012/07/12	BUY	55,000
2012/04/10	BUY	68,000
2012/01/10	BUY	68,000
2011/11/23	BUY	74,000
2011/10/13	BUY	74,000
2011/09/07	BUY	74,000
2011/07/07	BUY	63,000
2011/06/02	BUY	57,000
2011/04/13	BUY	57,000
2011/03/09	BUY	50,000

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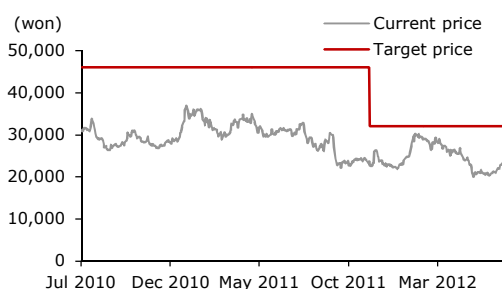
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## KISCO ratings and target price history



Date	Rating	TP (won)
2012/04/10	BUY	32,000
2012/01/10	BUY	32,000
2011/11/23	BUY	32,000
2011/10/13	BUY	46,000
2011/07/07	BUY	46,000
2011/06/02	BUY	46,000
2011/04/13	BUY	46,000
2011/03/09	BUY	46,000
2011/01/11	BUY	46,000
2010/11/23	BUY	46,000

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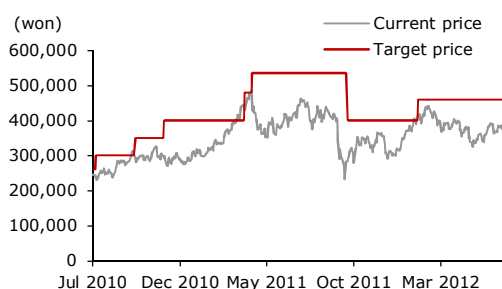
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## Korea Zinc ratings and target price history



Date	Rating	TP (won)
2012/04/10	BUY	460,000
2012/03/12	BUY	460,000
2012/02/10	BUY	460,000
2012/01/10	BUY	400,000
2011/11/23	BUY	400,000
2011/10/26	BUY	400,000
2011/10/13	BUY	400,000
2011/10/10	BUY	400,000
2011/08/01	BUY	535,000
2011/07/07	BUY	535,000

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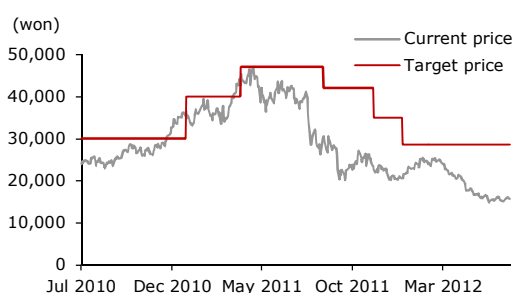
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  - Overweight: Investment weighting is higher than the market capitalization weighting
  - Neutral: Investment weighting is equal to the market capitalization weighting
  - Underweight: Investment weighting is lower than the market capitalization weighting

## Poongsan ratings and target price history



Date	Rating	TP (won)
2012/06/28	BUY	36,000
2012/04/10	BUY	40,000
2012/03/12	BUY	40,000
2012/01/10	BUY	40,000
2011/11/23	BUY	40,000
2011/10/13	BUY	40,000
2011/10/10	BUY	40,000
2011/08/03	BUY	52,000
2011/07/07	BUY	52,000
2011/06/02	BUY	52,000

Source: TONGYANG Securities

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I/We, as the research analyst/analysts who prepared this research report, do hereby certify that the views expressed in this report accurately reflect my/our personal views about the subject securities discussed in this report.

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- **Stock ratings** include an Investment Rating (Buy, Hold, Sell) as well as a Volatility Risk Rating (High, Low) that are based on the expected absolute return of a stock over the next 6 -12 months.
  - Buy: Low Risk if a stock is expected to return 10% or more; High Risk if a stock is expected to return 20% or more
  - Hold: Low Risk if a stock is expected to return between -10 and +10%; High Risk if a stock is expected to return between -20 and +20%
  - Sell: Low Risk if a stock is expected to decline by 10% or more; High Risk if a stock is expected to fall by 20% or more
- **Sector ratings** suggest 6 to 12 - month forward investment weighting of a given sector compared to its market capitalization weighting.
  - Overweight: Investment weighting is higher than the market capitalization weighting
  - Neutral: Investment weighting is equal to the market capitalization weighting
  - Underweight: Investment weighting is lower than the market capitalization weighting

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