POSCO (PKX)

Updated September 25th, 2018 by Nick McCullum

Key Metrics

Current Price:	$68	**5 Year CAGR Estimate:**	11.1%	**Volatility Percentile:**	83.2%
Fair Value Price:	$83	**5 Year Growth Estimate:**	5.0%	**Momentum Percentile:**	33.4%
% Fair Value:	82%	**5 Year Valuation Multiple Estimate:**	4.0%	**Valuation Percentile:**	86.7%
Dividend Yield:	2.1%	**5 Year Price Target**	$106	**Total Return Percentile:**	73.3%

Overview & Current Events

POSCO – formerly called Pohang Iron & Steel – is the third largest producer of steel and related products in the world. The company produced more than 42 million tons of steel in the most recent fiscal year. POSCO is headquartered in Seoul, South Korea. United States investors can initiate an ownership stake in POSCO through American Depository Receipts that trade on the New York Stock exchange under the ticker PKX with a market capitalization of $22 billion.

In late July, POSCO reported (7/23/18) financial results for the second quarter of fiscal 2018. In the quarter, revenue increased by 8.0% over the same period a year ago while gross profit rose by 27.3% and operating profit surged by 40.5% year-on-year. On the bottom line, POSCO's net profit rose by 13.9%, which is noticeably weaker than the company's gross profit performance due to a significant increase in non-operating expenses. POSCO's second quarter earnings release was positively received by the markets and shares rose by as much as 10% following the announcement.

Earlier this year, POSCO announced (4/18/18) that the company's Chief Executive Officer Kwon Oh-joon is stepping down early (his term was supposed to last until 2020) in an attempt to get a younger leader to run the company. Mr. Oh-joon is currently 69 years old. His successor is Choi Jeong-woo, which is a noteworthy choice as he represents the first Chief Executive Officer in POSCO's history that does not come from an engineering background.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	$11.68	$9.00	$12.00	$10.24	$7.62	$4.13	$1.72	-$0.39	$3.43	$8.01	***$8.25***	***$10.53***
DPS	$2.59	$1.57	$1.96	$2.25	$2.09	$1.77	$1.91	$1.78	$1.75	$2.25	***$2.45***	***$3.13***
Shares	306.28	306.65	308.13	308.98	308.98	319.13	319.97	319.98	319.99	320.00	***320.00***	***320.00***

POSCO's earnings-per-share history illustrates the company's dependence on steel prices. The company's adjusted earnings-per-share declined from $12 in fiscal 2010 to a $0.39 deficit in fiscal 2015. Now that prices have risen and the company's performance has normalized, we believe that POSCO's performance will improve moving forward. More specifically, we believe that POSCO is capable of delivering earnings-per-share of around $8.25 in fiscal 2018, with 5% annual growth thereafter. Applying a 5% growth rate to our 2018 earnings-per-share estimate of $8.25 allows us to calculate a 2023 earnings-per-share estimate of $10.53.

From a dividend perspective, POSCO's dividends are declared in Korean Won and are thus subject to foreign exchange fluctuations. We expect the company to pay US$2.45 of dividends in the current fiscal year and generate dividend growth of approximately 5% per year over the next half-decade.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	9.3	9.9	9.2	9.6	10.8	18.1	42.2	N/A	13.8	8.3	***8.3***	***10.1***
Avg. Yld.	2.4%	1.8%	1.8%	2.3%	2.5%	2.4%	2.6%	3.7%	3.7%	3.4%	***2.7%***	***2.9%***

POSCO's average price-to-earnings ratio over the last decade has been 10.1 if we exclude the years (2013 and 2014) in which the valuation metric was irrationally high due to depressed earnings. We believe that this valuation multiple is a

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fair indication of the firm's fair value. For context, POSCO is trading at a price-to-earnings ratio of 8.3 today. If the company's valuation expands to a price-to-earnings ratio of 10.1 over the next 5 years, this will add 4.0% to POSCO's annualized returns during this time period.

Income investors should note that the South Korean government applies a 22% withholding tax on dividends paid to international investors. This reduces POSCO's net dividend yield to 2.1%, from a gross dividend yield of 2.7%.

Safety, Quality, Competitive Advantage, & Recession Resiliency

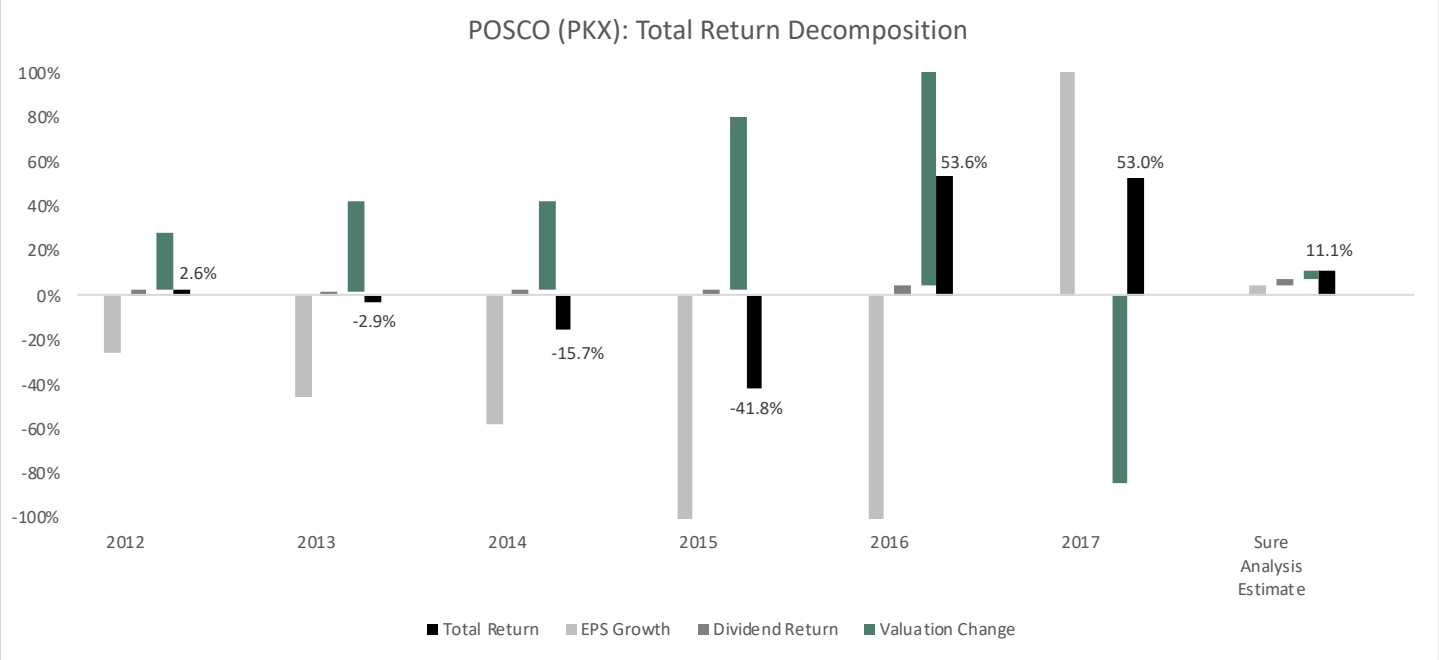
Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	23.0%	10.9%	11.7%	12.1%	9.0%	7.8%	8.8%	8.4%	8.6%	9.8%	***7.5%***	***7.5%***
Debt/A	39.6%	37.1%	45.2%	48.1%	46.5%	46.0%	47.3%	44.3%	42.9%	40.7%	***42.5%***	***42.5%***
Int. Cov.	N/A	23.7	20.5	8.7	6.0	6.0	3.1	1.3	3.9	9.7	***5.0***	***5.0***
Payout	22.2%	17.4%	16.3%	22.0%	27.4%	42.9%	111%	N/A	51.0%	28.1%	***29.7%***	***29.7%***
Std. Dev.	60.5%	47.8%	31.7%	29.8%	23.1%	21.0%	26.0%	26.6%	32.9%	24.4%	***26.0%***	***26.0%***

POSCO'S quality metrics reflect the difficulties of operating in the steel industry. The company generates little gross profits relative to its asset base, and its stock price standard deviation is far higher than the average in our investment universe. With that said, POSCO has covered its interest expense with its operating income each year during the last decade, and the company's balance sheet is sound with less than half of its total assets financed by debt.

Final Thoughts & Recommendation

POSCO appears priced to deliver low double-digits total returns from its current price. This is far superior than the total returns offered by its major domestic counterparts – Nucor Corporation (NUE) – which has low single-digit expected total returns. Accordingly, POSCO earns a buy recommendation from Sure Dividend at current prices, although we caution that the stock's performance will likely have far more volatility than the average security in our investment universe.

Total Return Breakdown by Year



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