# POSCO (PKX)

*Updated October 29th, 2020 by Nikolaos Sismanis*

## Key Metrics

| | | | | | |
|---|---|---|---|---|---|
| **Current Price:** | $46 | **5 Year CAGR Estimate:** | -7.9% | **Market Cap:** | $14.8B |
| **Fair Value Price:** | $26 | **5 Year Growth Estimate:** | 2.0% | **Ex-Dividend Date:** | N/A |
| **% Fair Value:** | 175% | **5 Year Valuation Multiple Estimate:** | -10.6% | **Dividend Payment Date:** | N/A |
| **Dividend Yield:** | N/A | **5 Year Price Target** | $29 | **Years Of Dividend Growth:** | N/A |
| **Dividend Risk Score:** | D | **Retirement Suitability Score:** | D | **Last Dividend Increase:** | N/A |

## Overview & Current Events

POSCO – formerly called Pohang Iron & Steel – is the third-largest producer of steel and related products in the world. The company – headquartered in Seoul, South Korea – produced about 36 million tons of steel in the most recent fiscal year. 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 $14.8 billion. POSCO reports results in Korean Won, but we'll be using U.S. Dollars throughout the report.

POSCO reported its Q3 earnings on October 23rd, with results coming in decent, despite the challenges in the industrial sector. Revenues declined by -15% year-over-year despite production volumes remaining stable, due to carbon steel prices dropping by an almost equal rate. Sales volumes remained stable, amounting to 7840 thousand tons, displaying strong production to sales conversation nonetheless.

We expect the company's fourth quarter to see stable production, as the company's flexible sales system introduced in Q2 seems to be working out. However, as steel prices remain low and industrial production is still adversely affected by COVID-19, investors should not expect significant improvements in the company's financials. We retain our FY2020 EPS estimates at $3.75, reflecting the company's weak Q2 results and lower steel prices for the year

On the positive side, POSCO thoughtfully managed its cash flows, slightly increasing its cash position by 1% from last quarter, while continuing deleveraging, reducing its long-term debt by around 1.6%.

## Growth on a Per-Share Basis

| Year | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2025 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **EPS** | $12.00 | $10.24 | $7.62 | $4.13 | $1.72 | -$0.39 | $3.43 | $8.01 | $5.43 | $4.84 | ***$3.75*** | ***$4.14*** |
| **DPS** | $1.96 | $2.25 | $2.09 | $1.77 | $1.91 | $1.78 | $1.75 | $2.25 | $1.94 | $1.25 | --- | ***$1.65*** |
| **Shares**[1] | 308 | 309 | 309 | 319 | 320 | 320 | 320 | 320 | 320 | 320 | ***318*** | ***318*** |

POSCO's earnings-per-share history demonstrates 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. We are cautious about global steel demand, especially in a potential scenario where COVID-19 reignites globally. As a result, we have a low forecast growth rate of just 2%. Management sees new growth opportunities ahead, such as environment-friendly vehicles & energy, mega-city industries, which could help drive some earnings growth over time. However, the current demand and margins remain a problem. The company reported an operating profit margin of just 4.7%, which builds little excitement in terms of a more profitable future.

While this figure expanded from last quarter's 1.2% as global demand for steel resumes, profitability risks remain, as commodity prices are highly unpredictable and are expected to fluctuate significantly in times of uncertainty, similar to the current situation.

Since our last repot, POSCO has not paid out any dividends nor has it announced any upcoming distributions. We expect that the DPS will remain suspended until the end of the year, before hopefully resuming to its previous levels.

[1] Share count in millions

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## Valuation Analysis

| Year | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | Now | 2025 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Avg. P/E** | 9.2 | 9.6 | 10.8 | 18.1 | 42.2 | --- | 13.8 | 8.3 | 13.6 | 10.7 | ***12.3*** | ***7.0*** |
| **Avg. Yld.** | 1.8% | 2.3% | 2.5% | 2.4% | 2.6% | 3.7% | 3.7% | 3.4% | 2.7% | 2.4% | --- | ***5.7%*** |

POSCO's average price-to-earnings ratio over the past decade has been around 10 (excluding the years 2014 and 2015) in which the valuation metric was not meaningful due to depressed earnings. Given the uncertainty surrounding the foreseeable future, we have assigned a fair value at 7 times earnings in the medium-term. Our multiple compression is attributable to the margin and demand issues discussed earlier, as well as the fluctuations of the commodity's price. POSCO is trading at a price-to-earnings power ratio of 12.3 today, higher than our previous report, as shares have advanced higher. Considering our lower medium-term P/E estimates, we see a small headwind from the valuation on the total return outlook. Income investors should note that the South Korean government applies a 22% withholding tax on dividends paid to international investors. This should reduce POSCO's net dividend yield, which we will have a better estimate of as soon as distributions are resumed.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

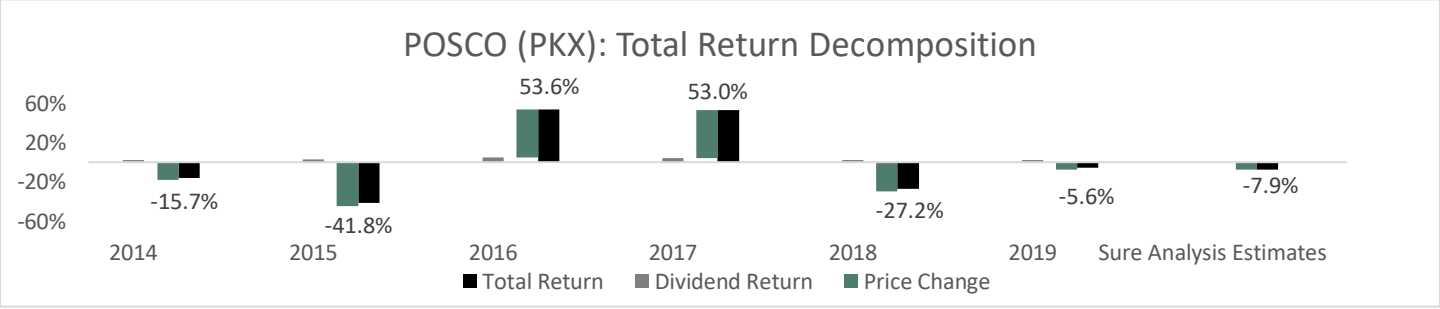
| Year | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2025 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Payout** | 32% | 30% | 23% | 21% | 26% | --- | 33% | 24% | 36% | 26% | --- | ***40%*** |

Despite POSCO's payout ratio being around one-third of earnings even at its past distribution levels, management suspended the dividend likely retain liquidity amid the unfavorable current price levels of steel. Based on the uncertainties surrounding the sector and COVID-19 disrupting the demand for steel, resumption of the dividend remains highly speculative. Thankfully, while competitive advantages are tough to come by for steel manufacturers, POSCO has a huge global presence in steel production as one of the largest such companies in the world. This affords it a brand presence and scale that smaller competitors cannot match. Recessions are obviously a huge negative shock to steel producers as demand for all kinds of products declines during downturns. Therefore, POSCO will suffer considerably during the current environment nonetheless.

## Final Thoughts & Recommendation

POSCO appears priced to deliver marginally negative returns in the coming years. Results for 2020 have been weak so far, and while there are some signs of strength, particularly in shipbuilding demand, we are cautious on the steel industry as a whole given COVID-19. Even assuming a DPS resumption to around $1.65 during the medium term, weak EPS generation accompanied by the potential for a valuation headwind are quite unlikely to generate a profitable investment case. Considering the uncertainties of the sector, as well as the stock being overvalued in terms of our estimated fair value, we rate POSCO a sell.

## Total Return Breakdown by Year




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## Income Statement Metrics

| Year | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|---|---|---|---|---|
| Revenue | 41265 | 62171 | 56101 | 56280 | 61437 | 51682 | 45561 | 53246 | 58952 | 59112 |
| Gross Profit | 7036 | 8220 | 6576 | 6243 | 6919 | 5744 | 5739 | 7317 | 7233 | 7281 |
| Gross Margin | 17.1% | 13.2% | 11.7% | 11.1% | 11.3% | 11.1% | 12.6% | 13.7% | 12.3% | 12.3% |
| SG&A Exp. | 1775 | 2522 | 2609 | 2752 | 3034 | 2821 | 2589 | 2562 | 1593 | 1593 |
| D&A Exp. | 2616 | 2044 | 2271 | 2447 | 3072 | 2842 | 2766 | 2917 | 2965 | 2965 |
| Operating Profit | 4836 | 5040 | 3212 | 2749 | 2759 | 2017 | 2502 | 4266 | 5013 | 5061 |
| Op. Margin | 11.7% | 8.1% | 5.7% | 4.9% | 4.5% | 3.9% | 5.5% | 8.0% | 8.5% | 8.6% |
| Net Profit | 3538 | 3290 | 2159 | 1249 | 600 | 151 | 1166 | 2438 | 1534 | 1553 |
| Net Margin | 8.6% | 5.3% | 3.8% | 2.2% | 1.0% | 0.3% | 2.6% | 4.6% | 2.6% | 2.6% |
| Free Cash Flow | -2117 | -3800 | -162 | -2055 | -415 | 4197 | 2416 | 2633 | 2982 | 2982 |
| Income Tax | 932 | 963 | 863 | 537 | 782 | 235 | 327 | 1049 | 1516 | 1527 |

## Balance Sheet Metrics

| Year | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|---|---|---|---|---|
| Total Assets | 60200 | 67745 | 73162 | 80260 | 78203 | 68474 | 66354 | 74679 | 69954 | 70427 |
| Cash & Equivalents | 3189 | 3973 | 4320 | 3981 | 3472 | 4130 | 2027 | 2445 | 2364 | 2364 |
| Acc. Receivable | N/A | 8869 | 9106 | 9781 | 9852 | 7591 | 7718 | 8031 | 8593 | 7732 |
| Inventories | 8686 | 10613 | 9770 | 9603 | 10179 | 7265 | 7879 | 10103 | 10281 | 10865 |
| Goodwill & Int. | 2801 | 2901 | 3267 | 4353 | 6188 | 5304 | 4907 | 5379 | 4451 | 4451 |
| Total Liabilities | 27240 | 32555 | 34000 | 36951 | 36974 | 30303 | 28460 | 30382 | 28151 | 28701 |
| Accounts Payable | 4461 | 4188 | 4540 | 4766 | 4503 | 3301 | 4227 | 3976 | 4215 | 4282 |
| Long-Term Debt | 17611 | 23165 | 23002 | 24829 | 24987 | 21387 | 18800 | 19716 | 18067 | 18067 |
| Total Equity | 30917 | 33140 | 36416 | 39741 | 37858 | 34942 | 35053 | 40866 | 38774 | 38732 |
| D/E Ratio | 0.57 | 0.70 | 0.63 | 0.62 | 0.66 | 0.61 | 0.54 | 0.48 | 0.47 | 0.47 |

## Profitability & Per Share Metrics

| Year | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|---|---|---|---|---|
| Return on Assets | 6.9% | 5.1% | 3.1% | 1.6% | 0.8% | 0.2% | 1.7% | 3.5% | 2.1% | 2.1% |
| Return on Equity | 12.5% | 10.3% | 6.2% | 3.3% | 1.5% | 0.4% | 3.3% | 6.4% | 3.9% | 3.9% |
| ROIC | 8.1% | 6.0% | 3.6% | 1.9% | 0.9% | 0.2% | 2.0% | 4.0% | 2.5% | 2.5% |
| Shares Out. | 308 | 309 | 309 | 319 | 320 | 320 | 320 | 320 | 320 | 320 |
| Revenue/Share | 133.92 | 201.20 | 181.57 | 180.36 | 192.47 | 161.52 | 142.39 | 166.40 | 184.22 | 184.72 |
| FCF/Share | -6.87 | -12.30 | -0.53 | -6.59 | -1.30 | 13.12 | 7.55 | 8.23 | 9.32 | 9.32 |

*Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.*


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