POSCO (PKX)

Updated February 6th, 2021 by Nikolaos Sismanis

Key Metrics

Current Price:	$59.5	**5 Year CAGR Estimate:**	0.2%	**Market Cap:**	$18.81B
Fair Value Price:	$47.0	**5 Year Growth Estimate:**	2.0%	**Ex-Dividend Date:**	03/30/2021[1]
% Fair Value:	127%	**5 Year Valuation Multiple Estimate:**	-4.6%	**Dividend Payment Date:**	06/04/2021
Dividend Yield:	2.8%	**5 Year Price Target**	$52	**Years Of Dividend Growth:**	N/A
Dividend Risk Score:	N/A	**Retirement Suitability Score:**	N/A	**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 34 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 $18.81 billion. POSCO reports results in Korean Won, but we'll be using U.S. Dollars throughout the report.

POSCO reported its full-year earnings on January 28th, 2021, with results coming in improved, despite the challenges in the industrial sector. Revenues declined by -12.5% year-over-year despite production volumes remaining stable, due to carbon steel prices dropping by an almost equal rate. Sales volumes remained relatively stable, amounting to 34,270 thousand tons, displaying strong production to sales conversation nonetheless.

Moving into FY2021, we expect the company to see stable production, as the company's flexible sales system introduced in Q2-2020 seems to be working out, counteracting the industry's slowdown. Steel have improved significantly over the past few months, but production is still adversely affected by COVID-19. Hence investors should not expect significant improvements in the company's financials. We initiate our FY2021 EPS estimates at $4.70, expecting slightly improved financials amid favorable still prices, while remaining prudent in case they don't remain at elevated prices enough for too long. On the positive side, POSCO thoughtfully managed its cash flows, increasing its cash position by 7.1% from last year, while continuing deleveraging, reducing its long-term debt by around 3%.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
EPS	$10.24	$7.62	$4.13	$1.72	-$0.39	$3.43	$8.01	$5.43	$4.84	$4.50	***$4.70***	***$5.19***
DPS	$2.25	$2.09	$1.77	$1.91	$1.78	$1.75	$2.25	$1.94	$2.35	$1.56	***$1.65***	***$1.65***
Shares[2]	309	319	320	320	320	320	320	320	318	318	***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 $10.24 in fiscal 2010 to a -$0.39 deficit in fiscal 2015. We are cautious about global steel demand, especially during the current environment of COVID-19 persisting 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 4.2%, which builds little excitement in terms of a more profitable future. Even if 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. POSCO's DPS levels have remained humble relative to its EPS as the company preserves cash to keep it afloat during the years of depressed still prices. Due to the commodity's demand improving as of recently, we expect management to slightly grow its annual DPS at around $1.65. However we don't expect any growth in the future.

[1] Estimated dividend dates based on past dividend dates.

[2] Share count in millions

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Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/E	9.6	10.8	18.1	42.2	---	13.8	8.3	13.6	10.7	13.8	***12.7***	***10.0***
Avg. Yld.	2.3%	2.5%	2.4%	2.6%	3.7%	3.7%	3.4%	2.7%	2.4%	2.6%	***2.8%***	***3.2%***

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, but also the favorable steel prices we have assigned a fair value at 10 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 12.7 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 would reduce POSCO's net dividend yield.

Safety, Quality, Competitive Advantage, & Recession Resiliency

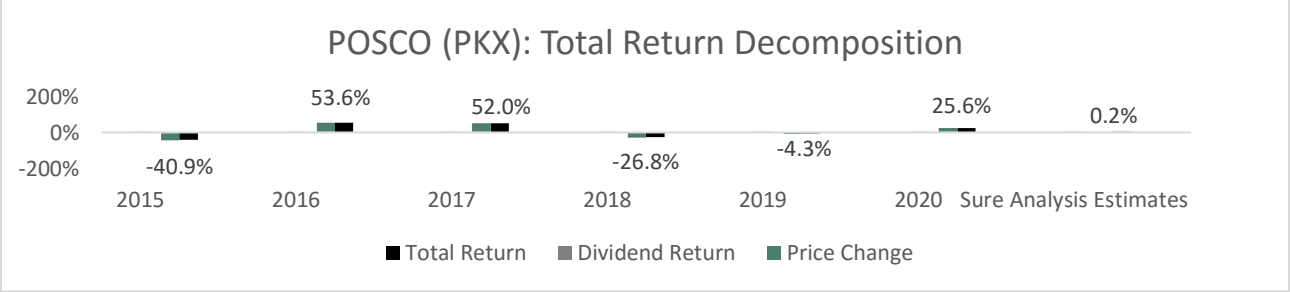
Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	30%	23%	21%	26%	---	33%	24%	36%	26%	34%	***35%***	***31%***

Despite POSCO's payout ratio being around one-third of earnings even at its past distribution levels, management will continue retaining a humble dividend to ensure liquidity amid any unfavorable price levels of steel in the future. Based on the uncertainties surrounding the sector and COVID-19 disrupting the demand for steel, the future net income and dividends remain 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 likely suffer considerably during the current environment nonetheless.

Final Thoughts & Recommendation

POSCO appears priced to deliver marginally positive returns in the coming years. Results in FY 2020 remained stable, 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 increase to around $1.65 during the medium term, weak dividend returns accompanied by the potential for a valuation headwind are quite unlikely to generate a substantially 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	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	62171	56101	56280	61437	51682	45561	53246	58952	59112
Gross Profit	8220	6576	6243	6919	5744	5739	7317	7233	7281
Gross Margin	13.2%	11.7%	11.1%	11.3%	11.1%	12.6%	13.7%	12.3%	12.3%
SG&A Exp.	2522	2609	2752	3034	2821	2589	2562	1593	1593
D&A Exp.	2044	2271	2447	3072	2842	2766	2917	2965	2965
Operating Profit	5040	3212	2749	2759	2017	2502	4266	5013	5061
Op. Margin	8.1%	5.7%	4.9%	4.5%	3.9%	5.5%	8.0%	8.5%	8.6%
Net Profit	3290	2159	1249	600	151	1166	2438	1534	1553
Net Margin	5.3%	3.8%	2.2%	1.0%	0.3%	2.6%	4.6%	2.6%	2.6%
Free Cash Flow	-3800	-162	-2055	-415	4197	2416	2633	2982	2982
Income Tax	963	863	537	782	235	327	1049	1516	1527

Balance Sheet Metrics

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

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	5.1%	3.1%	1.6%	0.8%	0.2%	1.7%	3.5%	2.1%	2.1%
Return on Equity	10.3%	6.2%	3.3%	1.5%	0.4%	3.3%	6.4%	3.9%	3.9%
ROIC	6.0%	3.6%	1.9%	0.9%	0.2%	2.0%	4.0%	2.5%	2.5%
Shares Out.	309	309	319	320	320	320	320	320	320
Revenue/Share	201.20	181.57	180.36	192.47	161.52	142.39	166.40	184.22	184.72
FCF/Share	-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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