POSCO (PKX)

Updated April 27th, 2021 by Nikolaos Sismanis

Key Metrics

Current Price:	$85	**5 Year CAGR Estimate:**	3.9%	**Market Cap:**	$25.1B
Fair Value Price:	$85	**5 Year Growth Estimate:**	2.0%	**Ex-Dividend Date:**	06/29/2021[1]
% Fair Value:	100%	**5 Year Valuation Multiple Estimate:**	0.1%	**Dividend Payment Date:**	09/04/2021
Dividend Yield:	2.2%	**5 Year Price Target**	$84.6	**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 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 $25.1 billion. POSCO reports results in Korean Won, but we'll be using U.S. Dollars throughout the report.

POSCO reported its Q1-2021 earnings on April 27th, 2021, with results coming in boosted, despite the challenges in the industrial sector. Revenues grew by 10.5% year-over-year, powered by 1.8% higher production volumes and skyrocketing carbon steel prices. Sales volumes amounted to 8,812 thousand tons, displaying a strong production to sales conversation rate, boosting POSCO's operating margin to 13.8% from 6.6% in Q1-2020.

Moving further into FY2021, we expect the company to see stable production, as its flexible sales system introduced in the first half of 2020 seems to be working out, counteracting the industry's slowdown. Steel prices have rallied by north of 50% YoY, as efforts from steel mills to produce more have been limited due to environmental restrictions imposed in China's steel capital, Tangshan, while demand keeps on growing. Hence, investors should continue expecting strong results unless steel production normalizes. We expect FY2021 EPS at $8.50, lower than this quarter's annual run rate (around $2.50,) to remain prudent against a potential decline in steel prices. Finally, POSCO thoughtfully managed its cash flows, increasing its cash position by continuing deleveraging. Long-term debt has declined by around 8% YoY.

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	***$8.50***	***$9.38***
DPS	$2.25	$2.09	$1.77	$1.91	$1.78	$1.75	$2.25	$1.94	$2.35	$1.56	***$1.75***	***$1.75***
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. Management sees new growth opportunities ahead, such as environment-friendly vehicles & energy, mega-city industries, which could help drive some earnings growth over time. Further, the current demand and margins have turned in POSCO's favor as of lately. We are cautious about steel's future global demand and price due to its cyclical nature. As a result, we have a low forecast growth rate of just 2%. Future profitability risks remain, as commodity prices are highly unpredictable and are expected to fluctuate significantly in times of uncertainty, and special circumstances, such as recent supply shortages.

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 $1.75. 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	***10.0***	***10.0***
Avg. Yld.	2.3%	2.5%	2.4%	2.6%	3.7%	3.7%	3.4%	2.7%	2.4%	2.6%	***2.2%***	***1.9%***

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, which matches the stock's current valuation

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 to around 1.7%.

Safety, Quality, Competitive Advantage, & Recession Resiliency

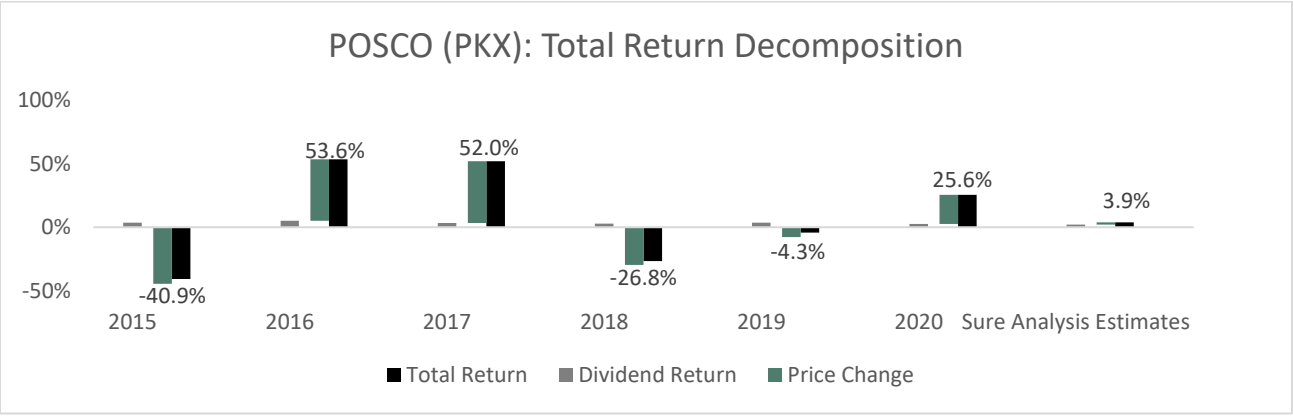
Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	30%	23%	21%	26%	---	33%	24%	36%	26%	34%	***21%***	***19%***

Despite POSCO's payout ratio being around one-fifth of its earnings based on our DPS projections, management is more than likely to continue paying a humble dividend to ensure liquidity amid any unfavorable price levels of steel in the future. Based on the uncertainties surrounding the sector, 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 slightly positive returns in the coming years. The first quarter for the year was rather strong, displaying signs of strength in steel's demand, particularly from the shipbuilding industry. Even assuming a DPS increase to around $1.75 during the medium term, weak dividend returns accompanied by the potential headwinds in the highly volatile steel do not make for the most attractive investment case. We believe the stock makes for a good vehicle for investors seeking exposure to steel by holding a quality company but not a reliable long-term investment. In that regard, we rate POSCO a sell.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	56101	56280	61437	51682	45561	53246	58952	59112	48750
Gross Profit	6576	6243	6919	5744	5739	7317	7233	7281	3981
Gross Margin	11.7%	11.1%	11.3%	11.1%	12.6%	13.7%	12.3%	12.3%	8.2%
SG&A Exp.	2609	2752	3034	2821	2589	2562	1593	1593	1954
D&A Exp.	2271	2447	3072	2842	2766	2917	2965	2965	3055
Operating Profit	3212	2749	2759	2017	2502	4266	5013	5061	2028
Op. Margin	5.7%	4.9%	4.5%	3.9%	5.5%	8.0%	8.5%	8.6%	4.2%
Net Profit	2159	1249	600	151	1166	2438	1534	1553	1351
Net Margin	3.8%	2.2%	1.0%	0.3%	2.6%	4.6%	2.6%	2.6%	2.8%
Free Cash Flow	-162	-2055	-415	4197	2416	2633	2982	2982	4376
Income Tax	863	537	782	235	327	1049	1516	1527	200

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	73162	80260	78203	68474	66354	74679	69954	70427	72520
Cash & Equivalents	4320	3981	3472	4130	2027	2445	2364	2364	4360
Acc. Receivable	9106	9781	9852	7591	7718	8031	8593	7732	7447
Inventories	9770	9603	10179	7265	7879	10103	10281	10865	8300
Goodwill & Int.	3267	4353	6188	5304	4907	5379	4451	4451	4080
Total Liabilities	34000	36951	36974	30303	28460	30382	28151	28701	28810
Accounts Payable	4540	4766	4503	3301	4227	3976	4215	4282	3444
Long-Term Debt	23002	24829	24987	21387	18800	19716	18067	18067	18800
Total Equity	36416	39741	37858	34942	35053	40866	38774	38732	40650
D/E Ratio	0.63	0.62	0.66	0.61	0.54	0.48	0.47	0.47	0.46

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	3.1%	1.6%	0.8%	0.2%	1.7%	3.5%	2.1%	2.1%	1.9%
Return on Equity	6.2%	3.3%	1.5%	0.4%	3.3%	6.4%	3.9%	3.9%	3.4%
ROIC	3.6%	1.9%	0.9%	0.2%	2.0%	4.0%	2.5%	2.5%	2.2%
Shares Out.	309	319	320	320	320	320	320	320	318
Revenue/Share	181.57	180.36	192.47	161.52	142.39	166.40	184.22	184.72	153.38
FCF/Share	-0.53	-6.59	-1.30	13.12	7.55	8.23	9.32	9.32	13.77

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

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