POSCO (PKX)

Updated January 29th, 2022 by Nikolaos Sismanis

Key Metrics

Current Price:	$55	**5 Year CAGR Estimate:**	8.7%	**Market Cap:**	$16.5 B
Fair Value Price:	$80	**5 Year Growth Estimate:**	-5.0%	**Ex-Dividend Date:**	03/30/2022[1]
% Fair Value:	69%	**5 Year Valuation Multiple Estimate:**	7.6%	**Dividend Payment Date:**	06/10/2022
Dividend Yield:	10.9%[2]	**5 Year Price Target**	$62	**Years Of Dividend Growth:**	N/A
Dividend Risk Score:	D	**Retirement Suitability Score:**	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 $16.5 billion. POSCO reports results in Korean Won, but we'll be using U.S. Dollars throughout the report.

POSCO reported its FY-2021 earnings on January 28th, 2022, with results coming in boosted, driven by a very favorable steel trading environment. Revenues grew by 50.5% year-over-year, powered by 3.7% higher production volumes and skyrocketing carbon steel prices. Sales volumes amounted to 35.4 thousand tons, displaying a strong production to sales conversation rate. This boosted POSCO's operating margin to 16.7% compared to 4.3% in FY-2020.

Moving into FY-2022, 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. While steel prices retreated in the second half of 2021, they have again rebounded significantly, possibly due to supply disruptions in Australia, which is a top iron ore exporter, due to a surge in coronavirus cases. In the meantime, steel demand in China will likely increase in the first half of 2022 as the construction and infrastructure sectors pick up, and the Chinese authorities adopt stimulus measures to shore up the economy.

Finally, POSCO thoughtfully managed its cash flows, increasing its cash position by continuing to deleverage. Debt/EBITDA now stands at 0.9 against 2.2 in the comparable period last year. Based on current steel prices, we forecast FY-2022 of $20. The company also updated its dividend policy, expecting to maintain a 30% payout ratio in 2022. Hence, we forecast a DPS of around $6.00 this year. The company also committed to buying back and canceling 13.3% of its stock within 2022.

Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
EPS	$7.62	$4.13	$1.72	-$0.39	$3.43	$8.01	$5.43	$4.84	$4.50	$22.5	***$20.00***	***$15.48***
DPS	$2.09	$1.77	$1.91	$1.78	$1.75	$2.25	$1.94	$2.35	$1.56	$2.56	***$6.00***	***$4.64***
Shares[3]	319	320	320	320	320	320	320	318	318	318	***276***	***200***

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 estimate a decline of 5% annually in EPS, assuming both steel prices and demand gradually retreat from the current frenzy. Future profitability

[1] Estimated dividend dates based on past dividend dates.
[2] Based on speculative, estimated DPS of $6.00 for FY-2022.
[3] Share count in millions

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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.

Valuation Analysis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
Avg. P/E	10.8	18.1	---	---	13.8	8.3	13.6	10.7	13.8	3.1	***3.1***	***4.0***
Avg. Yld.	2.5%	2.4%	2.6%	3.7%	3.7%	3.4%	2.7%	2.4%	2.6%	2.6%	***10.9%***	***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. We have assigned a fair value at 4.0 times earnings in the medium term, due to POSCO's current, inflated results.

Income investors should note that the South Korean government applies a 22% withholding tax on dividends paid to international investors.

Safety, Quality, Competitive Advantage, & Recession Resiliency

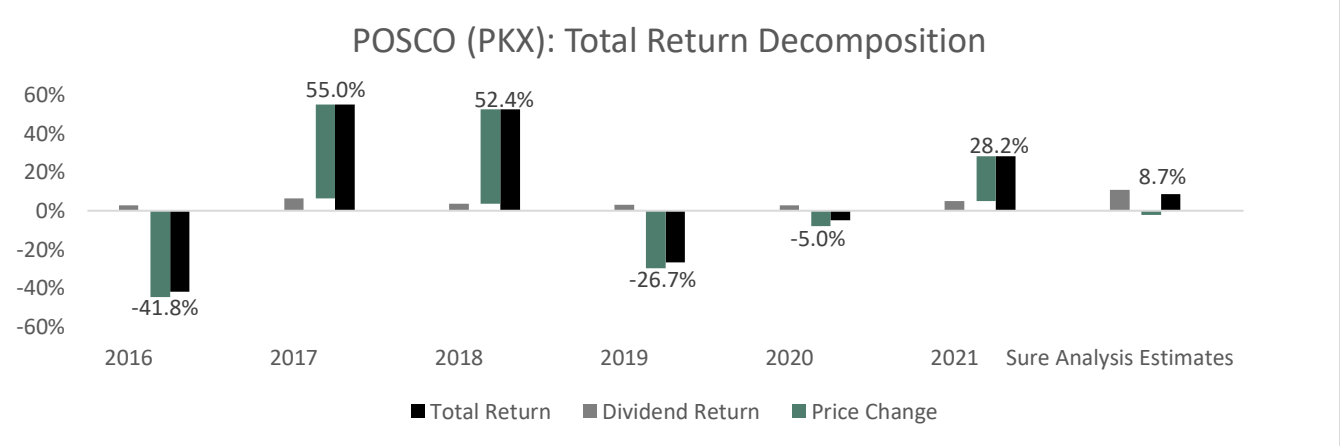
Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	23%	21%	26%	---	33%	24%	36%	26%	34%	***4.3%***	***30%***	***30%***

Based on Posco's updated dividend policy including maintaining payout ratio of around 30%, management is more than likely to continue preserving robust 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, nonetheless. 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 such an environment nonetheless.

Final Thoughts & Recommendation

POSCO appears priced to deliver positive returns in the coming years. Last year was an excellent trading period and the ongoing tailwinds in steel demand seem to be persisting entering 2022. We believe the stock makes for a good vehicle for investors seeking exposure to steel, but not a reliable long-term investment. In that regard, we rate POSCO as a hold based on our 8.7% annualized projected returns, driven primarily by POSCO's underlying future dividend payments.

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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