POSCO (PKX)

Updated July 29th, 2022 by Nikolaos Sismanis

Key Metrics

Current Price:	$47	**5 Year CAGR Estimate:**	13.5%	**Market Cap:**	$14.1 B
Fair Value Price:	$80	**5 Year Growth Estimate:**	-5.0%	**Ex-Dividend Date:**	09/30/2022[1]
% Fair Value:	58%	**5 Year Valuation Multiple Estimate:**	11.4%	**Dividend Payment Date:**	12/03/2022
Dividend Yield:	12.7%[2]	**5 Year Price Target**	$62	**Years Of Dividend Growth:**	N/A
Dividend Risk Score:	D	**Retirement Suitability Score:**	A	**Rating:**	Buy

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 $14.1 billion. POSCO reports results in Korean Won, but all figures listed in U.S. Dollars throughout the report.

POSCO reported its Q2-2022 earnings on July 21st, 2022, with results coming in boosted by a very favorable steel trading environment. Revenues grew by 25.7% year-over-year to a record $17.6 billion, powered by higher carbon steel prices. Still, consolidated operating profit, including earnings from POSCO International and POSCO Chemical, fell by roughly 4.7% to $1.61 billion due to higher expenses.

Moving forward 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 Q2, they have rebounded modestly, possibly due to the ongoing supply chain crisis worsening following China's new lockdowns. The strict measures applied by the Chinese government have led to a significant backlog of cargo and container ships standing by Shanghai's port. With logistics disruptions persisting globally, it's quite likely that steel prices will remain elevated. The lasting war in Ukraine and an import ban on Russian steel, coupled with monetary tightening globally, could also be a positive catalyst for steel prices.

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	$22.50	***$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]	77.2	78.0	79.8	80.0	80.0	80.0	80.0	80.1	79.1	76.7	***77.4***	***72.0***

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, and 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

[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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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.

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	***2.3***	***4.0***
Avg. Yld.	2.5%	2.4%	2.6%	3.7%	3.7%	3.4%	2.7%	2.4%	2.6%	2.6%	***12.7%***	***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

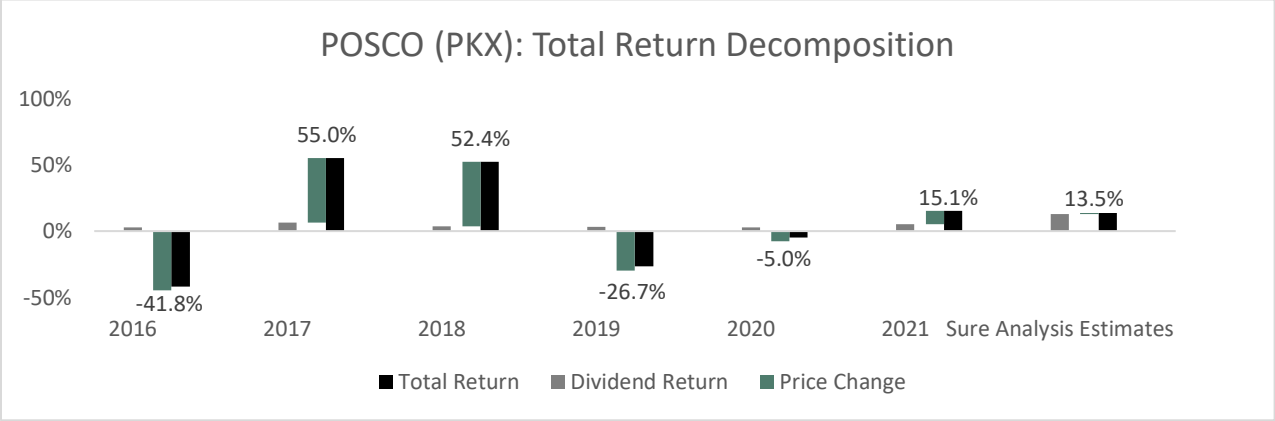
Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout	23%	21%	26%	---	33%	24%	36%	26%	34%	***4.3%***	***30%***	***30%***

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 through 2022. We believe the stock makes for a good vehicle for investors seeking exposure to steel, but not a reliable long-term investment. While we rate POSCO a buy based on our 13.5% annualized projected returns, a myriad of factors could affect this number in the coming years. Combined with risks attached to Korean corporate governance, the stock's investment case is highly speculative.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	56280	61437	51682	45561	53246	58952	59112	48750	66410
Gross Profit	6243	6919	5744	5739	7317	7233	7281	3981	10360
Gross Margin	11.1%	11.3%	11.1%	12.6%	13.7%	12.3%	12.3%	8.2%	15.6%
SG&A Exp.	2752	3034	2821	2589	2562	1593	1593	1954	1866
D&A Exp.	2447	3072	2842	2766	2917	2965	2965	3055	3127
Operating Profit	2749	2759	2017	2502	4266	5013	5061	2028	8140
Op. Margin	4.9%	4.5%	3.9%	5.5%	8.0%	8.5%	8.6%	4.2%	12.3%
Net Profit	1249	600	151	1166	2438	1534	1553	1351	5772
Net Margin	2.2%	1.0%	0.3%	2.6%	4.6%	2.6%	2.6%	2.8%	8.7%
Free Cash Flow	-2055	-415	4197	2416	2633	2982	2982	4376	2401
Income Tax	537	782	235	327	1049	1516	1527	200	1934

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets	80260	78203	68474	66354	74679	69954	70427	72520	77530
Cash & Equivalents	3981	3472	4130	2027	2445	2364	2364	4360	4011
Acc. Receivable	9781	9852	7591	7718	8031	8593	7732	7447	7784
Inventories	9603	10179	7265	7879	10103	10281	10865	8300	13520
Goodwill & Int.	4353	6188	5304	4907	5379	4451	4451	4080	3448
Total Liabilities	36951	36974	30303	28460	30382	28151	28701	28810	31570
Accounts Payable	4766	4503	3301	4227	3976	4215	4282	3444	5463
Long-Term Debt	24829	24987	21387	18800	19716	18067	18067	18800	18260
Total Equity	39741	37858	34942	35053	40866	38774	38732	40650	42320
LTD/E Ratio	0.62	0.66	0.61	0.54	0.48	0.47	0.47	0.46	0.43

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	1.6%	0.8%	0.2%	1.7%	3.5%	2.1%	2.1%	1.9%	7.7%
Return on Equity	3.3%	1.5%	0.4%	3.3%	6.4%	3.9%	3.9%	3.4%	13.9%
ROIC	1.9%	0.9%	0.2%	2.0%	4.0%	2.5%	2.5%	2.2%	9.1%
Shares Out.	319	320	320	320	320	320	320	318	307
Revenue/Share	180.36	192.47	161.52	142.39	166.40	184.22	184.72	153.38	216.48
FCF/Share	-6.59	-1.30	13.12	7.55	8.23	9.32	9.32	13.77	7.83

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

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