Korea Investment
& Securities Co., Ltd.

truefriend

Daewoo E&C (047040)

Company Brief / Construction

November 21, 2012

12M rating	**BUY (Maintain)**	
12M TP	**W13,000**	*from W13,000*
Up/downside	**+47%**	

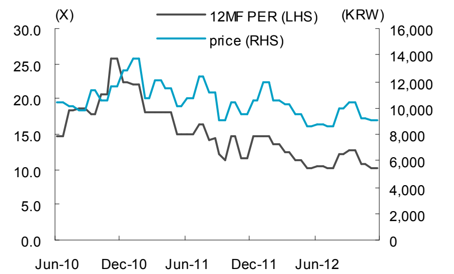
Stock Data

KOSPI (Nov 19, pt)	1,878
Stock price (Nov 19, KRW)	9,080
Market cap (USD mn)	3,295
Shares outstanding (mn)	416
52-Week high/low (KRW)	11,950/8,080
6M avg. daily turnover (USD mn)	4.2
Free float / Foreign ownership (%)	46.6/7.2
Major shareholders (%)	
The Korea Development Bank and 4 others	51.5
SEBT Investment Ltd	12.3

Performance

	1M	6M	12M
Absolute (%)	(11.4)	9.3	0.9
Relative to KOSPI (%p)	(8.0)	3.9	(1.2)

12MF PER trend



Source: WISEfn consensus

Kyungja Lee
822-3276-6155
kyungja.lee@truefriend.com

Hyungjun Ahn
822-3276-4460
hyungjoon@truefriend.com

Localization in Africa to bear fruit

Localization strategy borne from 30-year investment

As competition continues to intensify in the Middle East (ME), undercutting margins at construction companies, attention is rapidly shifting towards Daewoo E&C's unique competitiveness in Africa. This is a result of localization efforts that have been underway in Africa since 1978 centered on Nigeria. Specifically, Daewoo E&C has contributed heavily to the country's industrialization and created jobs, as: 1) Nigeria Daewoo (local subsidiary) was established in 1978, and 90% of its 5,781 workforce is comprised of locals, 2) the company has built several manufacturing yards in Africa, which has strict regulations on local manufacturing obligations, and 3) Daewoo E&C operates a youth education program. Similar to Samsung Engineering in Saudi Arabia, localization can be a highly effective tool, but it takes substantial time to develop.

Stable inflation in Africa and strong relationships with IOCs

Conditions are improving in terms of order generation in Africa. 1) Inflation, which has been a chronic burden on regional economies, is stabilizing, backed by food assistance from developed countries. With the most pressing problem resolved, Africa is ready to push forward with industrialization. 2) Many oil & gas development projects are progressing via joint ventures with international oil companies (IOCs) due to the turbulent financial markets, and Daewoo E&C has secured the most power and upstream orders from IOCs fueled by its regional strengths. While there are still dispute risks regarding profit allotment between Africa and IOCs since 2009, IOCs are still pushing to enter the market, especially Nigeria, which is a global top 10 exporter of oil and gas.

Growing into a heavyweight; contrarian strategy to continue

Daewoo E&C's overseas orders reached only W3trn as of two years ago, but surged to W5trn in 2011 and should reach W6trn this year. Overall, Daewoo E&C has posted rapid growth over the past three years fueled by a contrarian strategy. We consider the Jizan refinery project that Daewoo E&C secured recently via a JV with a Japanese firm, JGC, as a prime example. Unlike other Korean players, Daewoo E&C began focusing on Africa 30 years ago, and is only now re-entering the ME market, as other players gradually withdraw. Meanwhile, 2013 NP should surge 74% YoY on improvements in volume and margins. As such, we maintain Daewoo E&C as our top sector pick with a TP of W13,000 derived via SOTP methodology.

	2010A	2011A	2012F	2013F	2014F
Sales (W bn)	6,713	7,020	8,250	9,676	10,638
OP (W bn)	(991)	332	398	577	668
EBT (W bn)	(1,152)	210	325	567	688
NP of con. int. (W bn)	(828)	177	252	438	532
EBITDA (W bn)	(881)	391	458	638	731
Net debt (W bn)	2,262	1,427	1,133	903	843
OP margin (%)	(14.8)	4.7	4.8	6.0	6.3
ROE (%)	(26.1)	5.3	7.4	12.3	13.6
Dividend yield (%)	0.0	0.0	1.0	1.0	1.0
EPS (KRW)	(2,577)	431	613	1,067	1,295
chg. (%, YoY)	NM	NM	42.1	74.2	21.4
BPS (KRW)	8,145	8,291	8,513	9,185	10,083
DPS (KRW)	0	0	100	100	100
PER (x)	NM	24.4	14.8	8.5	7.0
PBR (x)	1.6	1.3	1.1	1.0	0.9
EV/EBITDA (x)	(7.3)	14.7	10.6	7.3	6.2

Maintain Daewoo E&C as top pick with TP of W13,000

We have recommended Daewoo E&C as our top pick since Aug based on the following. 1) Housing has emerged as a growth engine, as the company supplies more than 20,000 units since 2011 (2007-2012 average annual supply 7,000 units). 2) Daewoo E&C has secured solid margins and new orders in the Africa market, facing almost no competition from other Korean builders. 3) The company's financial structure has also improved since KDB's takeover. Meanwhile, 2012 housing supply should exceed 22,000, with a pre-sale ratio over 80%, bolstering mid-term earnings visibility. Interest expenses should also fall W45bn YoY in 2012 and W33.8bn in 2013.

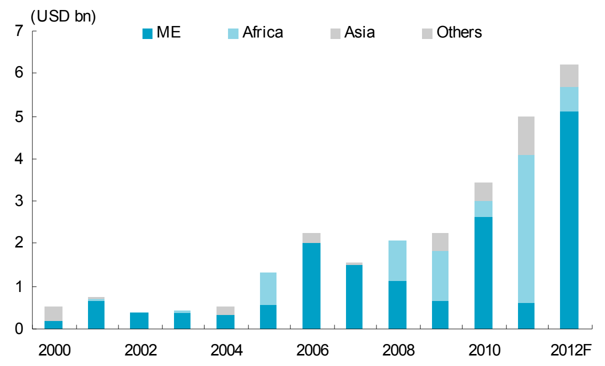
Daewoo E&C has secured an average USD1.4bn in overseas orders from Africa since 2006, rather than the ME, the key market for most Korean builders. And, 80% of this year's orders should also be derived from Africa, fueling hopes the company will secure USD6bn in overseas orders this year, after winning a record W5.4trn last year.

Table 1. Valuation (W bn)

		Note
1) Operation value	6,012	
2012F~2013F NOPLAT	429	Based on 2012~2013 12M Forward NOPLAT
Target multiple	14.0	Major builders' target
2) Shares available for sale	450	
3) Net debt	1,133	Based on 2012
Shareholder's value(1+2-3)	5,329	
Target price (KRW)	13,000	

Source: Korea Investment & Securities

Figure 1. Daewoo E&C's overseas orders

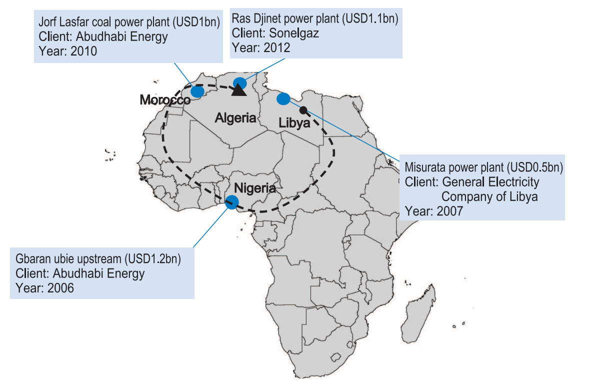


Source: Korea Investment & Securities

Effects of localization in Africa

Daewoo E&C first entered Africa in 1978 as it shifted away from the ME. With competition intensifying in the region, Daewoo E&C entered Africa due to its high growth potential and ample resources, including land and population. Specifically, Daewoo E&C focused on Libya, Nigeria and Sudan. With the localization efforts in three countries, Daewoo E&C has been able to secure Africa as an almost captive market, and has expanded into other countries, such as Algeria.

Figure 2. Localization strategy in Africa



Source: Korea Investment & Securities

1) Daewoo E&C established Daewoo Nigeria Ltd. in 1978. As 90% of the total 5,781 workers are locals, the company is contributing to regional job creation.
2) The company has built and owns several manufacturing yards in Nigeria. Most are located in the Niger Delta, the largest resource reserves to be developed. Of note, the Brass LNG project will also be developed in the Niger Delta. Currently, Africa and Brazil have the highest local contribution obligation ratios in the world (weighting of manufacturing process that must be done by local companies), which is serving as an entry barrier.
3) Daewoo E&C has formed a solid network through social contributions, such as sending Nigerian youths to Qatar for training. Based on these efforts, the Nigerian government signed a MOU for 10GW IPP construction projects in Jul with apparatus and materials companies, GE and Siemens, and Daewoo E&C only. Based on the long localization efforts, Daewoo E&C's overseas sales should grow 46% YoY in 2012 and 24% YoY in 2013. And, the weighting of overseas sales should increase from 38% in 2012 to 41% in 2013.

Figure 3. Manufacturing yard in Niger Delta

1.Module fabrication
2.Fabrication shop
3.Painting/Blasting
4.Pipe fabrication
5.Plant workshop
6.Load-out jetty
7.Main office

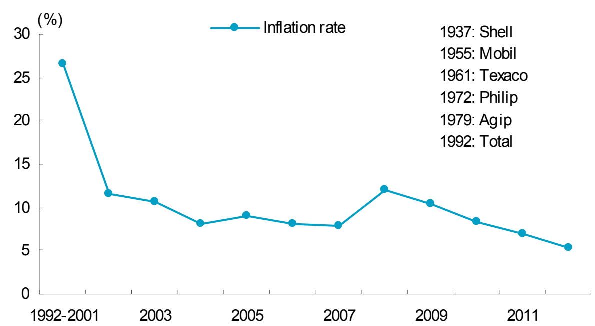
Source: Daewoo E&C

Of note, the effectiveness of localization has been confirmed with Samsung Eng, which continues to win orders in Saudi Arabia, after meeting the kingdom's 'Saudization' policies, by employing 1,213 local workers. As job creation has emerged as a focal issue in the MENA region, each country requires overseas companies contribute to the local economy rather than unconditionally opening doors to any foreign company, serving as another entry barrier.

Stabilizing inflation in Africa and solid relationship with IOCs

Conditions are improving in terms of order generation in Africa. 1) Inflation, which has been a chronic burden on regional economies, is stabilizing, backed by food assistance from developed countries. With the most pressing problem resolved, Africa is ready to push forward with industrialization. 2) Many oil & gas development projects are progressing via joint ventures with IOCs due to the turbulent financial markets. In fact, Daewoo E&C has secured solid relationships with IOCs by attracting regional investments since 2006. While there are still dispute risks regarding profit allotment between Africa and IOCs since 2009, IOCs are still pushing to enter the market, especially Nigeria, which is a global top 10 exporter of oil and gas.

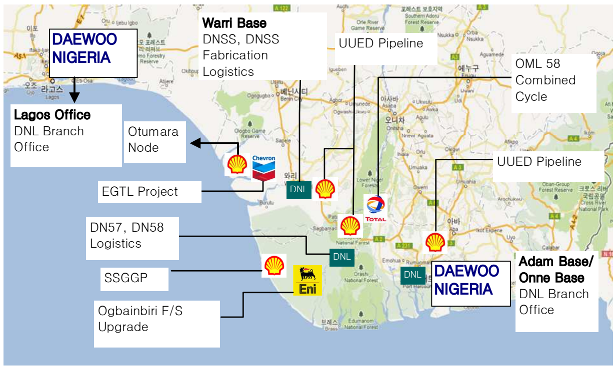
Figure 4. Inflation rate and IOC operating in Africa



Source: Ministry of Economy & Planning, Korea Investment & Securities

Furthermore, the strong IOC relationships are also bolstering power plant orders. African governments have required flaring gas generated from resource development as fuel due to environmental concerns. And, IOCs have been obligated to invest in local IPPs in exchange for resource rights. As such, IOCs tender substantial IPP projects in Africa, and Daewoo E&C's experience in IOC upstream projects has been extended to power plant orders.

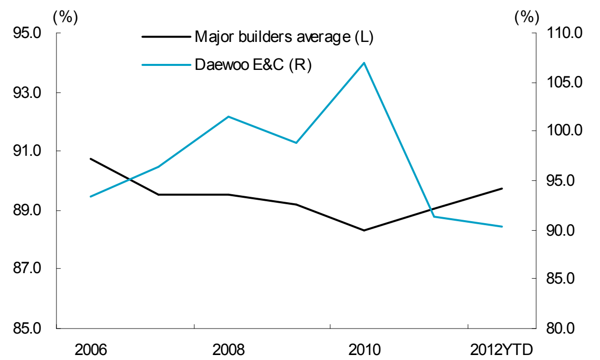
Figure 5. Daewoo E&C's IOC projects and local subsidiaries in Nigeria



Source: Daewoo E&C, Korea Investment & Securities

Construction companies have posted earnings shocks recently due to severe competition in overseas markets in 2010-2011. In contrast, Daewoo E&C's growth in margins and volume are just beginning due to its expansion efforts in Africa, although growth had been slow due to its low ME exposure. Of note, earnings forecasts for most major builders have been revised down, except Daewoo E&C, which has been adjusted upward.

Figure 6. Major builders' COGS ratio, 89-90% expected

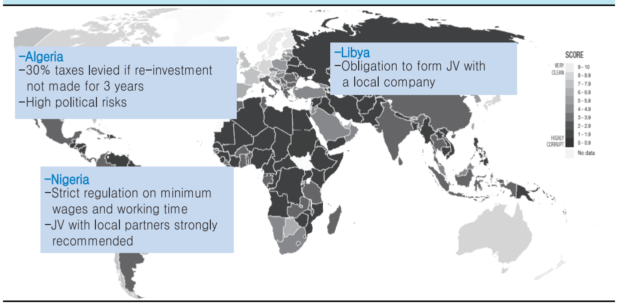


Source: Korea Investment & Securities

From lightweight to heavyweight; contrarian strategy to continue

While Daewoo E&C has secured its position in Africa, efforts by competitors to enter the market have become a risk. But competition is unlikely to intensify over the near term, as: 1) a quick entry into the market is difficult given the poor business environment in Africa due to corruption, and 2) Africa requires substantial long-term effort and investments to enter. Meanwhile, Daewoo E&C is also attempting to re-enter the ME market as other competitors gradually withdraw. We consider the Jizan refinery project that Daewoo E&C secured recently via a JV with a Japanese firm, JGC, as a prime example. Daewoo E&C has posted rapid growth over the past three years fueled by a contrarian strategy. Daewoo E&C's overseas orders reached only W3trn as of two years ago, but surged to W5trn in 2011 and should reach W7trn in 2013 through contrarian strategy.

Figure 7. Entry barriers to Africa: Corruption and local sourcing demands



Source: Korea Investment & Securities

Company overview & Glossary

Since being founded in 1973, Daewoo E&C has carried out projects in more than 30 countries, implementing civil & housing, power & industrial plants, architecture, LNG facilities and large-scale overseas projects for 40 years. It was taken over by KDB in 2011 and was ranked third best capability at Korean construction companies in 2012.

- Brass LNG: Clients are comprised of NNPC (49.0%), Conoco Phillips (17.0%), Eni (17.0%), Total (17.0%). LNG development agreement was signed in 2006 and FEED is completed. This project is being implemented in ample oil reserve, Niger Delta. Daewoo E&C has large manufacturing yard near the project site.
- Niger Delta: Located on South Nigeria, Niger Delta has a huge amount of oil reserves, and conflicts between the Nigerian government and Movement for the Emancipation of the Niger Delta is very serious. Exploited oil reserves almost reaches 36bn barrel, but development faces difficulties due to frequent terror activity and unstable public safety
- Saudization: Regulation that a certain number of local workers must be employed and domestically produced equipments and materials be used when foreign company hopes to do business in Saudi Arabia (at least 7.0% of total employees). Otherwise, doing business may face limitations.

Changes to recommendation and price target

Company (Code)	Date	Recommendation	Price target
Daewoo E&C(047040)	01-06-11	BUY	W13,000
	02-06-11	BUY	W17,000
	07-27-12	BUY	W11,000
	08-24-12	BUY	W13,000

Balance sheet

FY-ending Dec. (W bn)	2010A	2011A	2012F	2013F	2014F
Current assets	6,560	6,197	5,869	6,593	7,036
Cash & cash equivalent	482	714	743	774	745
Accounts & other receivables	3,315	3,239	3,807	4,465	4,909
Inventory	617	1,016	908	871	851
Non-current assets	3,300	3,272	3,674	4,127	4,474
Investment assets	1,323	1,315	1,494	1,691	1,859
Tangible assets	663	774	789	805	822
Intangible assets	99	105	124	145	159
Total assets	9,860	9,469	9,543	10,720	11,510
Current liabilities	3,512	3,687	3,912	4,761	5,129
Accounts & other payables	1,703	1,633	1,919	2,251	2,660
ST debt & bond	340	23	0	0	0
Current portion of LT debt	572	674	854	904	924
Non-current liabilities	2,994	2,370	2,129	2,184	2,241
Debentures	1,202	719	369	219	169
LT debt & financial liabilities	671	629	559	489	449
Total liabilities	6,506	6,056	6,041	6,945	7,370
Controlling interest	3,283	3,344	3,437	3,716	4,089
Capital stock	2,078	2,078	2,078	2,078	2,078
Capital surplus	548	548	548	548	548
Capital adjustments	(110)	(99)	(99)	(99)	(99)
Retained earnings	586	732	943	1,340	1,832
Minority interest	71	68	65	59	51
Shareholders' equity	3,354	3,412	3,502	3,775	4,140

Income statement

FY-ending Dec. (W bn)	2010A	2011A	2012F	2013F	2014F
Sales	6,713	7,020	8,250	9,676	10,638
Gross profit	126	683	818	994	1,135
SG&A expense	337	355	377	427	477
Other operating gains	(781)	4	(44)	10	10
Operating profit	(991)	332	398	577	668
Financial income	52	62	75	79	81
Interest income	52	62	75	79	81
Financial expense	229	196	163	133	110
Interest expense	229	196	163	133	110
Other non-operating profit	4	10	8	39	43
Gains (Losses) in associates, subsidiaries and JV	13	2	8	6	6
Earnings before tax	(1,152)	210	325	567	688
Income taxes	(325)	36	79	137	167
Net profit	(828)	174	247	430	522
Net profit of controlling interest	(828)	177	252	438	532
Other comprehensive profit	(8)	(116)	(116)	(116)	(116)
Total comprehensive profit	(835)	58	131	314	406
Total comprehensive profit of controlling interest	(834)	61	134	320	414
EBITDA	(881)	391	458	638	731

Cash flow

FY-ending Dec. (W bn)	2010A	2011A	2012F	2013F	2014F
C/F from operating	(155)	(106)	607	529	411
Net profit	(828)	174	247	430	522
Depreciation	106	54	54	54	54
Amortization	4	5	6	8	8
Net incr. in W/C	(16)	(466)	262	(10)	(203)
Others	579	127	38	47	30
C/F from investing	(613)	980	(315)	(286)	(330)
CAPEX	(127)	(99)	(85)	(75)	(71)
Decr. in fixed assets	29	4	15	5	0
Incr. in investment	(458)	36	(290)	(309)	(280)
Net incr. in intangible assets	(2)	(9)	(25)	(29)	(23)
Others	(55)	1,048	70	122	44
C/F from financing	565	(642)	(263)	(211)	(111)
Incr. in equity	0	0	0	0	0
Incr. in debts	0	0	(263)	(170)	(70)
Dividends	(16)	0	0	(41)	(41)
Others	581	(642)	0	0	0
C/F from others	(0)	(0)	0	0	0
Increase in cash	(203)	232	29	32	(29)

Note: Based on K-IFRS (consolidated)

Key financial data

FY-ending Dec.	2010A	2011A	2012F	2013F	2014F
per share data (KRW)					
EPS	(2,577)	431	613	1,067	1,295
BPS	8,145	8,291	8,513	9,185	10,083
DPS	0	0	100	100	100
Growth (%)					
Sales growth	(5.6)	4.6	17.5	17.3	9.9
OP growth	0.0	0.0	19.8	45.0	15.9
NP growth	0.0	0.0	42.1	74.2	21.4
EPS growth	0.0	0.0	42.1	74.2	21.4
EBITDA growth	0.0	0.0	17.1	39.3	14.5
Profitability (%)					
OP margin	(14.8)	4.7	4.8	6.0	6.3
NP margin	(12.3)	2.5	3.1	4.5	5.0
EBITDA margin	(13.1)	5.6	5.6	6.6	6.9
ROA	(8.7)	1.8	2.6	4.2	4.7
ROE	(26.1)	5.3	7.4	12.3	13.6
Dividend yield	0.0	0.0	1.0	1.0	1.0
Stability					
Net debt (W bn)	2,262	1,427	1,133	903	843
Debt/equity ratio (%)	85.6	67.5	58.3	49.5	43.5
Valuation (X)					
PER	NM	24.4	14.8	8.5	7.0
PBR	1.6	1.3	1.1	1.0	0.9
PSR	0.6	0.6	0.5	0.4	0.4
EV/EBITDA	(7.3)	14.7	10.6	7.3	6.2

- **Guide to Korea Investment & Securities Co., Ltd. stock ratings based on absolute 12-month forward share price performance**
  - BUY: Expected to give a return of +15% or more
  - Hold: Expected to give a return between -15% and +15%
  - Underweight: Expected to give a return of -15% or less
  - Korea Investment & Securities does not offer target prices for stocks with Hold or Underweight ratings.

- **Guide to Korea Investment & Securities Co., Ltd. sector ratings for the next 12 months**
  - Overweight: Recommend increasing the sector's weighting in the portfolio compared to its respective weighting in the Kospi (Kosdaq) based on market capitalization.
  - Neutral: Recommend maintaining the sector's weighting in the portfolio in line with its respective weighting in the Kospi (Kosdaq) based on market capitalization.
  - Underweight: Recommend reducing the sector's weighting in the portfolio compared to its respective weighting in the Kospi (Kosdaq) based on market capitalization.

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  Neither the analysts covering these companies nor their associates own any shares of as of November 20, 2012.

  Prepared by: Kyungja Lee

Korea Investment & Securities Co., Ltd.

HEAD OFFICE
CHUN SOO LIM, Executive Vice President, Head of Global Institutional Group (cslim@truefriend.com +822 3276 5800)
PAUL CHUNG, Sales Trading (pchung@truefriend.com +822 3276 5843)
27-1 Yoido-dong, Youngdeungpo-ku, Seoul 150-745, Korea
Toll free: US 1 866 258 2552 HK 800 964 464 SG 800 8211 320
Fax: 822 3276 5681~3
Telex: K2296

NEW YORK
DONG KIM, Managing Director (dkim@kisamerica.com +1 212 314 0681)
ELAINE LIM, Head of Sales (Elaine@kisamerica.com +1 212 314 0686)
JU KIM, Sales (jukim@kisamerica.com +1 212 314 0683)
Korea Investment & Securities America, Inc.
1350 Avenue of the Americas, Suite 1110
New York, NY 10019
Fax: 1 201 592 1409

HONG KONG
DANIEL KIM, Managing Director, Head of HK Sales (daniel.kim@kisasia.com +852 2530 8950)
SANGME LEE, Merchandising Director (sangme.lee@kisasia.com +852 2530 8910)
DAN SONG, Sales (dan.song@kisasia.com, +822-3276-5621)
JUN HWAN KIM, Sales (jun.kim@kisasia.com, +852-2530-8912)
Korea Investment & Securities Asia, Ltd.
Suite 2201-2, Jardine House
1 Connaught Place, Central, Hong Kong
Fax: 852-2530-1516

SINGAPORE
SUNG NAMGOONG, Managing Director, Head of Singapore Sales (snamgoong@truefriend.com +65 6501 5601)
ALEX JUN, Sales (alex.jun@truefriend.com +65 6501 5602)
Korea Investment & Securities Singapore Pte Ltd
1 Raffles Place, #43-04, One Raffles Place
Singapore 048616
Fax: 65 6501 5617

LONDON
JJ MOON, Managing Director (jamesmoon@kiseurope.com +44 207 065 2765)
MINGOO KANG, Sales (mingookang@kiseurope.com, +44 207 065 2760)
Korea Investment & Securities Europe, Ltd.
2nd Floor, 35-39 Moorgate
London EC2R 6AR
Fax: 44-207-236-4811
Telex: 8812237