

K-IFRS issue 4: Asset revaluation and goodwill amortization

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- **Asset revaluation: No change to fundamentals due to ROE decline**
- **Non-amortization of goodwill: W2trn OP increase expected in the short-term (Kospi-listed firms)**
- **But cautious about possible asset impairment in the long-term**

Asset revaluation: No change to fundamentals due to ROE decline

There is a myth that asset revaluation allowed under IFRS would benefit companies who booked assets below the appraised values. K-GAAP required an acquisition-cost model for tangible assets but K-IFRS allows a choice between cost and asset revaluation models (K-IFRS 1016, "Property, Plant and Equipment"). Even in the acquisition-cost model, fair value can be used in the initial IFRS statement of financial position as deemed cost for an item in tangible assets (K-IFRS 1101). This makes the application of asset revaluation easier at the transition date. If a company wants to enhance its shareholders' equity, it would most likely prefer asset revaluation with the adoption of IFRS.

Companies with real estate that feature a higher official price than book include KT, Korea District Heating and Hyundai E&C. However, if asset revaluation enhances shareholders' equity, it would drive down ROE with all else being equal. The fair PB multiple should then drop proportionately to reflect ROE. Swelling equity is merely an illusion and there is little impact on fundamentals.

Non-amortization of goodwill: W2trn OP increase expected in the short-term (Kospi-listed firms)

Under K-GAAP, companies amortize goodwill using straight-line method for a reasonable period within 20 years. But in K-IFRS, assets acquired in a business combination are not amortized but booked as impaired after evaluation at the end-period. The impairment test is subject to discussion with auditors and most companies are likely to see bigger profit in the short-term with the absence of goodwill amortization.

The total goodwill amount for 674 Kospi-listed firms is ~W42.5trn in consolidated K-GAAP as of 2009. If we assume the residual period at 15 years, a simple calculation yields a W2.8trn expected OP increase from the non-amortization of goodwill. The effective rise in OP is estimated at W2trn considering double-counts due to the complicated shareholder structures.

The non-amortization of goodwill should increase net profit in the short-term but may risk impairment losses in a lump sum when the industries are in a slump. We urge caution for companies with a substantial amount of goodwill when estimating earnings or doing a corporate analysis.

<Table 1> Asset revaluation effect

(W bn)

Code	Company	Total assets	Total liabilities	Total equity (A)	Book value	Land Official value	Difference (B)	B/A
A003620	Ssangyong Motor	1,475	1,166	309	211	393	182	58.9%
A001470	Sambu Const.	1,042	698	344	102	274	171	49.7%
A006390	Hyundai Cement	860	697	163	163	239	76	46.7%
A034120	Seoul Broadcasting System	660	193	467	85	274	188	40.3%
A030200	KT	24,101	13,060	11,041	1,422	5,406	3,984	36.1%
A071320	Korea District Heating	3,339	2,250	1,089	349	634	285	26.2%
A004960	Hanshin Const.	1,096	770	326	50	128	77	23.8%
A002000	Hankuk Glass Ind.	668	127	540	109	212	104	19.2%
A008770	Hotel Shilla	1,174	590	583	143	251	108	18.5%
A006650	Korea Petrochemical Ind.	932	416	517	155	243	88	17.1%
A005990	Maeil Dairy Ind.	535	267	268	50	95	45	16.8%
A004370	Nongshim	1,935	627	1,308	371	582	211	16.1%
A004000	Samsung Fine Chemicals	1,271	223	1,048	22	181	159	15.2%
A005250	Green Cross Holdings	926	369	558	106	188	82	14.8%
A026870	Daehan City Gas	812	384	427	91	153	63	14.7%
A000720	Hyundai Eng. & Const.	8,993	5,437	3,556	235	735	500	14.1%
A000100	Yuhan	1,243	171	1,072	119	262	144	13.4%
A023590	Daou Technology	720	206	513	47	108	61	11.9%
A003300	Hanil Cement	1,441	443	999	221	339	118	11.8%
A003240	Taekwang Ind.	1,991	89	1,901	330	553	224	11.8%
A002030	Asia Cement	811	123	689	146	227	81	11.8%
A025860	Namhae Chemical	580	200	381	66	109	43	11.3%
A014830	UNID	606	199	407	53	97	44	10.9%
A104700	KISCO	947	245	702	95	169	74	10.5%
A001310	Poonglim Ind.	1,149	953	196	69	89	20	10.0%

Note: Non-consolidated K-GAAP as of 2010.

Source: Korea Investment & Securities

<Table 2> Goodwill amortization effect

(W bn)

Code	Company	Fiscal month	Total assets	Intangible assets	Goodwill	Amortization of intangible assets	Operating profit	Market capital (A)	Goodwill amortization (B)	B/A
A000140	Hite Holdings	12	1,717	886	883	49	312	374	59	15.7%
A016880	Woongjin Holdings	12	1,784	989	894	85	330	542	60	11.0%
A000150	Doosan	12	2,748	6,468	4,812	435	534	3,526	321	9.1%
A001520	Tongyang Major	12	1,460	523	451	51	225	378	30	8.0%
A034730	SK C&C	12	3,193	7,565	5,651	311	3,732	5,500	377	6.9%
A034020	Doosan Heavy I&C	12	9,176	6,464	4,710	406	356	6,329	314	5.0%
A042670	Doosan Infracore	12	4,779	5,048	3,546	319	-395	4,989	236	4.7%
A003600	SK Holdings	12	10,240	6,140	4,071	191	3,730	9,044	271	3.0%
A001040	CJ	12	2,791	1,313	1,035	110	737	2,394	69	2.9%
A011810	STX	12	2,524	957	442	56	-192	1,333	29	2.2%
A002790	AmoreG	12	1,501	434	503	40	310	1,759	34	1.9%
A003240	Taekwang Ind.	12	1,830	464	464	120	252	1,689	31	1.8%
A009410	Taeyoung E&C	12	1,986	118	72	9	65	433	5	1.1%
A055550	Shinhan Financial Group	12	255,018	4,263	4,076	494	2,098	24,895	272	1.1%
A067250	STX Offshore & Shipbuilding	12	7,623	753	381	35	11	2,481	25	1.0%
A010620	Hyundai Mipo Dockyard	12	5,996	580	554	31	443	3,800	37	1.0%
A014790	Halla Eng & Const.	12	1,392	116	65		297	453	4	1.0%
A013580	Kyeryong Const.	12	1,118	19	18	6	48	126	1	0.9%
A017670	SK Telecom	12	19,298	3,992	1,738		1,879	13,121	116	0.9%
A000880	Hanwha	12	5,649	359	352	76	1,504	3,696	23	0.6%

Note: Consolidated K-GAAP as of 2009. We assumed the residual period as 15 years. Double-calculating is possible due to the shareholder structure by company.

Source: Korea Investment & Securities