

## Kumho Tire (073240)

Hold (Maintain)

Stock price (Apr 25, KRW)	8,320
Market cap (USD mn)	1,168
Shares outstanding (mn)	158
52W High/Low (KRW)	11,350/7,630
6M avg. daily turnover (USD mn)	7.5
Free float (%)	58.0
Foreign ownership (%)	4.6
Major shareholders (%)	
Woori Bank	14.2
Korea Development Bank	13.5

Yr to	Sales	OP	NP	EPS	% chg	EBITDA	PE	EV/EBITDA	PB	ROE	DY
Dec	(W bn)	(W bn)	(W bn)	(KRW)	(YoY)	(W bn)	(x)	(x)	(x)	(%)	(%)
2015A	3,040	136	(69)	(439)	NM	340	NM	10.4	0.9	(5.9)	-
2016A	2,947	120	(36)	(228)	NM	344	NM	11.3	1.2	(3.2)	-
2017F	3,196	200	22	138	NM	449	62.1	8.9	1.2	2.0	-
2018F	3,612	275	71	447	224.0	530	19.2	7.7	1.1	6.1	-
2019F	3,782	278	66	416	(6.9)	539	20.6	7.7	1.1	5.4	-

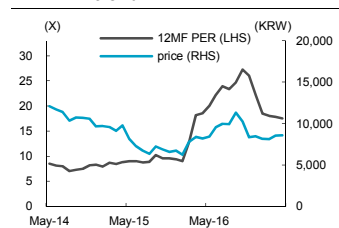
Note: NP in equity-method accounting

## Uncertainty lingers over stake sale

## Performance

	1M	6M	12M
Absolute (%)	(4.1)	(21.1)	2.2
Rel. to Kospi (%p)	(5.4)	(29.0)	(6.8)

## 12MF PE trend



**Ball back in Doublestar's court:** The sale of Kumho Tire (Kumho) by creditors is dragging on. We previously forecast a deal would be reached by April 19, the deadline for Chairman Park Sam-koo to exercise the right of first refusal (see our report *Kumho Tire: Stake disposal clouded by uncertainty* published February 28). But Park gave up the right and called for a re-bid, claiming that his request to allow a consortium of investors to buy back the stake was not honored and unfair. Accordingly, the creditors will have to renegotiate the Kumho deal with China's Qingdao Doublestar (Doublestar) over the next six months. If the negotiations are not wrapped up within the period and Doublestar fails to pay whatever price, Doublestar would automatically lose its preferred bidder status and the stake sale will return to its starting point. Park's right of first refusal would be restored.

**Normality hinges on labor costs:** A major question is whether Kumho would be able to fly high again if management regains stability. We believe the key lies in labor-management relations. While profitability eroded due to strike actions following graduation from the debt-workout program, labor costs went up. Despite a drop in rubber prices, the weighting of labor costs compared to sales increased. Accordingly, Kumho's COGS-to-sales ratio is rising unlike industry competitors (Figures 61-66). Even if Chairman Park succeeds in acquiring the creditors' stake, the road to management normalization faces a bumpy ride if labor-management relations are not stable.

**Sluggish 1Q17 due to eroded OE tire sales in China:** We estimate 1Q17 sales at W731.8bn (+4.3% YoY) and OP at W39.4bn (+160.5% YoY) with a 5.4% OPM. Despite rising utilization at the Georgia plant, OE tire sales were sluggish in China. The reason is that Kia Motors' sales dropped in January-February amid disputes with dealers and Hyundai Motor/Kia Motors saw their sales volume plummet amid political tensions spurred by the THAAD issue. With OE products accounting for more than 70% of its total tire sales in China, Kumho was hit hard by the carmakers' sales decline. Even if we assume that earnings will return to normal, the stock price is heavy at the current level. We maintain Hold.

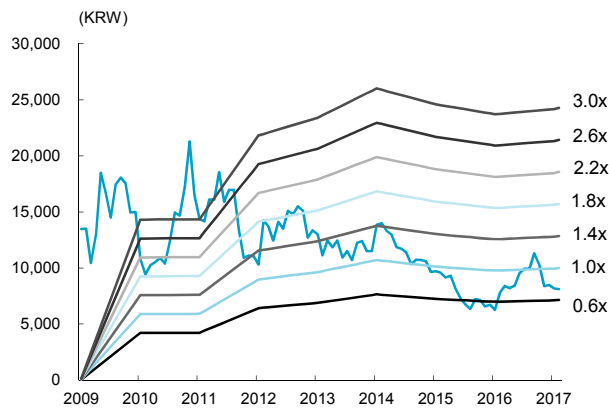
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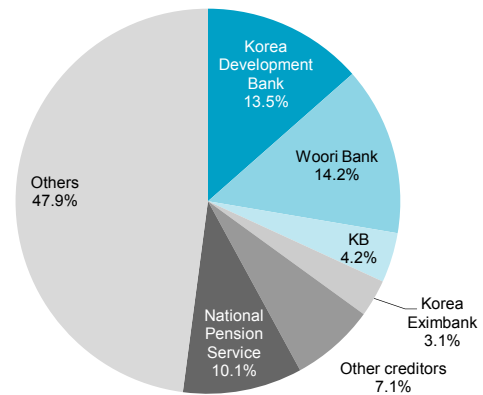
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Figure 59. 12MF PB band



Source: Korea Investment & Securities

Figure 60. Ownership breakdown (42% held by creditors, as of Mar 2017)



Source: Korea Investment & Securities

Table 20. 1Q17 preview

(W bn, %, %p)

	1Q17F			YoY	QoQ	Consensus	
	Preview	Previous	Chg.			1Q17F	Chg.
Sales	732	764	(4.2)	4.3	8.7	725	0.9
OP	39	44	(11)	NM	483.1	26	51.5
OPM	5.4	5.2				3.6	
NP	-3	2	(259)	NM	NM	-1	NM

Source: Quantwise, Korea Investment & Securities estimates

Table 21. Earnings revisions

(W bn, %, %p)

	Previous		Revised		Chg.	
	2017F	2018F	2017F	2018F	2017F	2018F
Sales	3,308	3,648	3,196	3,612	(3.4)	(1.0)
OP	219	259	200	275	(8.6)	6.2
OPM	6.6%	7.1%	6.3%	7.6%	(0.3)	0.5
NP	42	79	22	71	(48.1)	(10.6)

Source: Korea Investment & Securities estimates

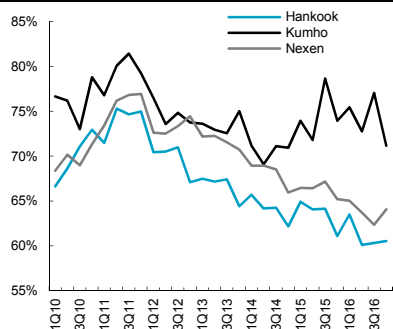
Table 22. 2017F earnings revisions in detail

('000 tires, KRW/tire, USD/tonne, %)

	Previous	Revised	Chg.
Production volume	50,041	48,831	(2.4)
ASP	66,104	65,453	(1.0)
Input cost	1,922	2,000	4.1

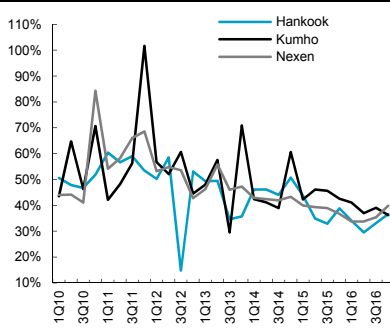
Source: Korea Investment & Securities estimates

Figure 61. COGS-to-sales: Up despite falling rubber prices



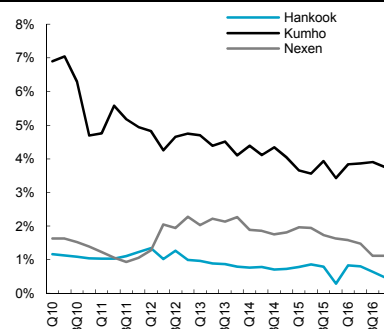
Source: Korea Investment & Securities

Figure 62. Raw material costs-to-sales: Expensive raw materials not a cause of higher COGS ratio



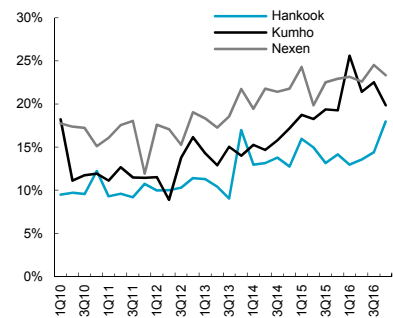
Source: Korea Investment & Securities

Figure 63. Interest costs-to-sales: Stable interest expenses



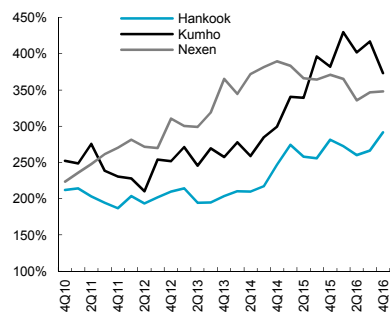
Source: Korea Investment & Securities

Figure 64. Labor costs-to-sales: Main reason for higher COGS



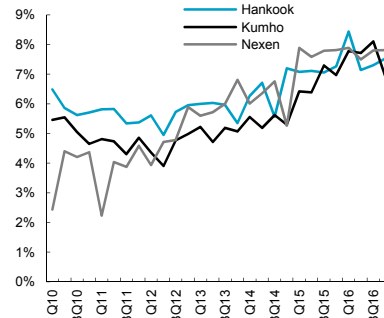
Source: Korea Investment & Securities

Figure 65. Tangible assets-to-sales: Greater tangible assets



Source: Korea Investment & Securities

Figure 66. Depreciation-to-sales: Rapid depreciation increase



Source: Korea Investment & Securities

Table 23. Quarterly earnings forecasts

(000 tires, W bn, KRW/tire, USD/tonne)

	1Q16	2Q16	3Q16	4Q16	1Q17F	2Q17F	3Q17F	4Q17F	2015	2016	2017F	2018F	2019F
Sales	702	745	710	791	732	779	803	882	3,040	2,947	3,196	3,612	3,782
OP	15	41	9	55	39	44	51	66	136	120	200	275	278
OPM	2.2%	5.5%	1.3%	7.0%	5.4%	5.7%	6.3%	7.5%	4.5%	4.1%	6.3%	7.6%	7.3%
EBT	-13	-0	-32	7	-4	1	7	23	-65	-38	27	88	82
NP	-14	-8	-31	17	-3	1	6	18	-69	-36	22	71	66
Sales % YoY	-7.0%	-5.1%	-1.0%	0.9%	4.3%	4.6%	13.1%	11.5%	-11.6%	-3.1%	8.4%	13.0%	4.7%
OP % YoY	-65.6%	-26.3%	NM	29.0%	160.5%	8.9%	433.9%	20.0%	-62.1%	-11.7%	66.9%	37.2%	1.0%
NP % YoY	NM	NM	NM	NM	NM	NM	NM	5.8%	NM	NM	NM	224.0%	-6.9%
<b>Utilization by region</b>													
Global	73%	74%	71%	76%	70%	73%	75%	81%	73%	76%	78%	84%	86%
Korea	79%	80%	76%	83%	78%	85%	78%	85%	79%	80%	82%	85%	85%
China	71%	78%	73%	73%	65%	60%	73%	80%	63%	74%	70%	77%	80%
Vietnam	105%	123%	118%	131%	105%	105%	105%	105%	106%	119%	105%	105%	105%
US	2%	10%	24%	38%	50%	70%	80%	90%	0%	18%	73%	95%	100%
<b>Major assumptions</b>													
Production volume ('000)	11,327	12,025	11,513	12,367	11,443	11,946	12,187	13,256	47,771	47,232	48,831	52,558	53,424
ASP (KRW/unit)	61,955	61,941	61,675	63,955	63,955	65,234	65,886	66,545	65,069	62,407	65,453	68,726	70,788
Input price (USD/tonne)	1,498	1,460	1,524	1,573	1,708	1,936	2,008	2,049	1,693	1,514	2,000	2,248	2,455
NR input price	1,402	1,365	1,506	1,505	1,761	2,235	2,238	2,298	1,640	1,445	2,198	2,638	3,034
SR input price	1,799	1,802	1,827	1,978	2,198	2,553	2,868	2,986	2,055	1,852	2,732	3,278	3,770
<b>YoY</b>													
Production volume ('000)	-3.2%	-10.3%	24.7%	-6.1%	1.0%	-0.7%	5.8%	7.2%	-6.1%	-1.1%	3.4%	7.6%	1.6%
ASP (KRW/unit)	-3.9%	5.8%	-20.6%	7.4%	3.2%	5.3%	6.8%	4.1%	-3.8%	-4.1%	4.9%	5.0%	3.0%
Input price (USD/tonne)	-15.6%	-13.5%	-10.2%	-2.5%	14.0%	32.6%	31.8%	30.3%	-15.1%	-10.6%	32.2%	12.4%	9.2%

Source: Korea Investment &amp; Securities

### Company overview & Glossary

Kumho Tire is Korea's second-largest tire manufacturer (no. 14 worldwide) and generates 96% of sales from the passenger car/light truck radial segment. The other 4% comes from the truck/bus radial segment. The company manufactures 51% of its products in Korea, 44% in China and 5% in Vietnam. The manufacturer entered a debt-workout program in 2009 and graduated at end-2014.

## Balance sheet

FY-ending Dec. (W bn)	2015A	2016A	2017F	2018F	2019F
Current assets	1,632	1,558	1,745	1,973	2,065
Cash & cash equivalents	244	164	160	181	189
Accounts & other receivables	619	645	700	791	828
Inventory	543	549	595	673	705
Non-current assets	3,588	3,564	3,686	3,843	3,946
Investment assets	104	94	102	116	121
Tangible assets	2,998	2,952	3,022	3,093	3,161
Intangible assets	35	29	31	35	37
Total assets	5,220	5,122	5,431	5,816	6,012
Current liabilities	2,262	2,335	2,462	2,659	2,708
Accounts & other payables	754	710	770	870	911
ST debt & bonds	1,013	836	886	945	945
Current portion of LT debt	480	750	760	795	795
Non-current liabilities	1,697	1,573	1,733	1,850	1,932
Debentures	0	0	0	0	0
LT debt & financial liabilities	1,289	1,147	1,271	1,328	1,385
Total liabilities	3,959	3,908	4,195	4,509	4,639
Controlling interest	1,143	1,102	1,123	1,190	1,253
Capital stock	790	790	790	790	790
Capital surplus	247	247	247	247	247
Other reserves	(20)	(20)	(20)	(20)	(20)
Retained earnings	85	54	75	142	204
Minority interest	118	112	113	116	120
Shareholders' equity	1,261	1,214	1,236	1,306	1,372

## Cash flow

FY-ending Dec. (W bn)	2015A	2016A	2017F	2018F	2019F
C/F from operations	225	188	243	272	313
Net profit	(67)	(38)	22	71	66
Depreciation	198	218	243	248	254
Amortization	6	6	6	7	7
Net incr. in W/C	(32)	(146)	(54)	(100)	(34)
Others	120	148	26	46	20
C/F from investing	(582)	(265)	(431)	(400)	(359)
Capex	(676)	(365)	(313)	(319)	(322)
Decr. in fixed assets	4	185	0	0	0
Incr. in investment	88	6	(8)	(13)	(5)
Net incr. in intangible assets	(0)	1	(9)	(11)	(9)
Others	2	(92)	(101)	(57)	(23)
C/F from financing	391	6	184	148	55
Incr. in equity	0	0	0	0	0
Incr. in debt	293	(72)	185	152	58
Dividends	0	0	0	0	0
Others	98	78	(1)	(4)	(3)
C/F from others	13	(9)	0	0	0
Increase in cash	47	(80)	(4)	21	8

Note: K-IFRS (consolidated)

## Income statement

FY-ending Dec. (W bn)	2015A	2016A	2017F	2018F	2019F
Sales	3,040	2,947	3,196	3,612	3,782
COGS	2,265	2,202	2,318	2,579	2,710
Gross profit	775	745	878	1,033	1,072
SG&A expenses	639	625	678	759	794
Operating profit	136	120	200	275	278
Financial income	19	16	16	16	16
Interest income	5	3	3	4	4
Financial expenses	150	152	158	168	176
Interest expenses	111	113	119	129	136
Other non-operating profit	(70)	(21)	(31)	(35)	(36)
Gains (Losses) in associates, subsidiaries and JV	0	0	0	0	0
Earnings before tax	(65)	(38)	27	88	82
Income taxes	2	0	5	18	16
Net profit	(67)	(38)	22	71	66
Net profit of controlling interest	(69)	(36)	22	71	66
Other comprehensive profit	4	(5)	0	0	0
Total comprehensive profit	(64)	(43)	22	71	66
Total comprehensive profit of controlling interest	(66)	(41)	21	67	63
EBITDA	340	344	449	530	539

## Key financial data

FY-ending Dec.	2015A	2016A	2017F	2018F	2019F
Per-share data (KRW)					
EPS	(439)	(228)	138	447	416
BPS	7,234	6,976	7,107	7,532	7,928
DPS	0	0	0	0	0
Growth (%)					
Sales growth	(11.6)	(3.1)	8.4	13.0	4.7
OP growth	(62.1)	(11.7)	66.9	37.2	1.0
NP growth	NM	NM	NM	224.0	(6.9)
EPS growth	NM	NM	NM	224.0	(6.9)
EBITDA growth	(37.5)	1.1	30.5	18.0	1.6
Profitability (%)					
OP margin	4.5	4.1	6.3	7.6	7.3
NP margin	(2.3)	(1.2)	0.7	2.0	1.7
EBITDA margin	11.2	11.7	14.1	14.7	14.2
ROA	(1.3)	(0.7)	0.4	1.3	1.1
ROE	(5.9)	(3.2)	2.0	6.1	5.4
Dividend yield	-	-	-	-	-
Dividend payout ratio	NM	NM	0.0	0.0	0.0
Stability					
Net debt (W bn)	2,364	2,432	2,534	2,635	2,671
Debt/equity ratio (%)	220.7	225.2	236.0	234.8	227.7
Valuation (x)					
PE	NM	NM	62.1	19.2	20.6
PB	0.9	1.2	1.2	1.1	1.1
EV/EBITDA	10.4	11.3	8.9	7.7	7.7

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