Korea Investment
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Doosan Group

Sector Brief / Industrial Conglomerate

April 13, 2011

Company	Rating	TP (KRW)
• Doosan Corp. (000150)	BUY (-)	200,000 (-)
• Doosan Infracore (042670)	NA	NA

Ideas on Doosan's next step

Returning Bobcat to normal will become a top priority

Doosan Group's major affiliates have a combined market cap of W16trn, which peaked at W30trn in October 2007. The decline in the market cap is attributed partly to sluggish earnings at Doosan Heavy Industries, a core subsidiary, and an increase in the number of unpaid pre-sale homes at Doosan Engineering & Construction. But more importantly, it was due to the group's W6trn acquisition of Bobcat and resulting huge financial burden. Tackling the Bobcat-related woes will become a top priority in the group's financial policy decision. A re-rating of Doosan Group companies' shares will be achievable when Bobcat turns profitable and the Bobcat-related financial risks, including the put-back option exercise, are dealt with.

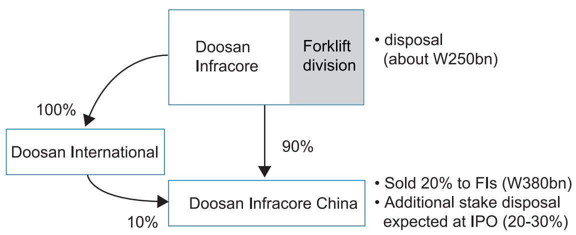
Speeding up forklift division sale and DICC listing, as a pre-emptive measure to dispel put-back option risk

Regarding Bobcat, the two most imminent issues faced by Doosan Group in 2012 are the put-back option exercise (USD1.2bn) and debt rescheduling (USD2.3bn). Doosan Infracore (DI) recently disposed of a 20% stake in its wholly owned subsidiary, Doosan Infracore China Corp. (DICC). We view the stake disposal as a move by the group to demonstrate its strong commitment to removing the Bobcat risk prior to expiration of the put-back options in 2012. Given that Doosan Group needs to raise at least W1trn to ease concerns related to the put-back option exercise and to receive favorable financing terms, we expect additional divestitures of assets such as Doosan Infracore's forklift business and stakes in DICC. Regarding DICC's IPO, the key issues are when, how, and where DICC will go public. The share valuation and amendments to Korea's Monopoly Regulation and Fair Trade Law will be the two key variables to DICC's IPO.

Vigorous asset purchase and disposals are likely through DIP Holdings

We expect DIP Holdings (a subsidiary of Doosan Corp.) to ramp up efforts to divest its stakes in Doosan DST, SRS, and KAI in 2011. Finding buyers for SRS and KAI will gather pace following the Samhwa C&C disposal in 2010. According to news reports, DI's forklift business is likely to be sold to DIP Holdings or to outside investors. Even if DIP Holdings buys the forklift business, the negative impacts from lingering concerns, which view the deal as indirect support for group companies, should be limited to Doosan Corp.'s shares given the following. First, the possibility is already in the news and known to investors. Second, DIP Holdings can finance the acquisition of the forklift business through the disposal of its equity stakes, which would not impose a financial burden on Doosan Corp. Third, DIP Holdings can invite financial investors and pay a fair price for the buyout deal. We note that, despite the criticism that DIP Holdings was a channel to bail out group companies, the value of Doosan Corp's stake in DIP Holdings more than doubled (W 623bn) over two years and bolstered Doosan Corp's NAV.

Restructuring plan



Source: Korea Investment & Securities

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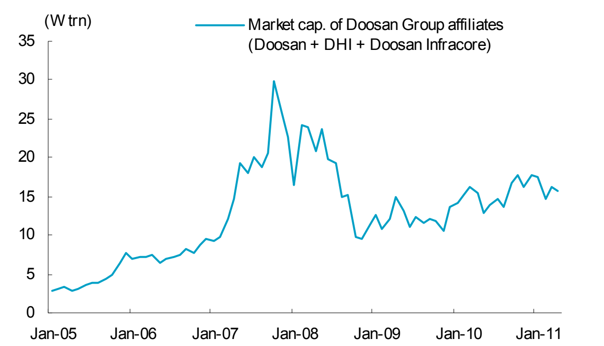
Returning Bobcat to normal will become a top priority

Doosan Group's major affiliates have a combined market cap of W16trn, which peaked at W30trn in October 2007. Decline in the market cap is attributed partly to sluggish earnings at Doosan Heavy Industries, a core subsidiary, and liquidity concerns over Doosan Engineering & Construction (Doosan E&C). But more importantly, it was due to the group's W6trn acquisition of Bobcat, the US construction equipment maker, and resulting huge financial burden. Tackling the Bobcat-related woes will become a top priority in the group's financial policy decision. A re-rating of Doosan Group companies' shares will be achievable if the group takes preemptive steps and smoothly deals with the upcoming financial issues by 2011-1H12, including the scheduled put-back option exercise by financial investors (FIs) in the Bobcat acquisition.

Combined market cap of Doosan Group's major affiliates

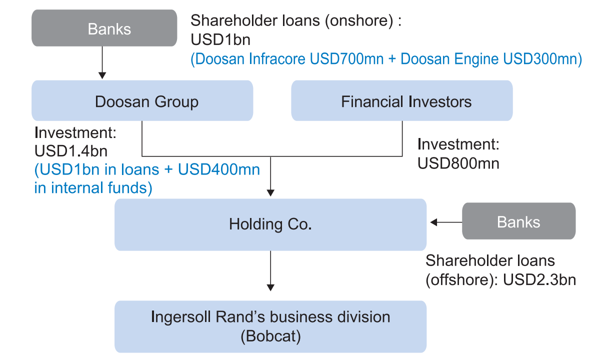


Source: Korea Investment & Securities

Why Bobcat?

Doosan Group acquired Bobcat at W5trn and injected an additional W1trn to restore the company's financials. As such, Doosan Group invested W6trn, equal to 21% of the group's total assets, in the Bobcat deal. Most of the investment was funded by the borrowed money of Doosan Infracore, Doosan Engine, and a paper company established for the acquisition (see the chart below). Besides the huge financial burden, Bobcat has struggled on the operating front with continuing net loss of USD540mn in 2009 and USD230mn in 2010. The operating-front woes escalate risks for the group as a whole.

Bobcat acquisition structure



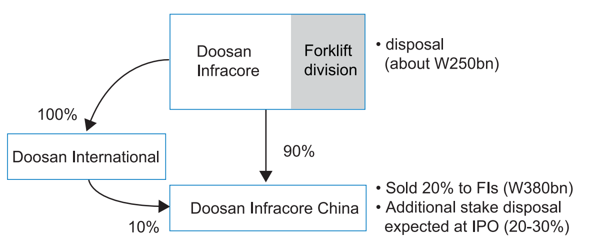
Source: Korea Investment & Securities

Bobcat risks to gradually ease

Regarding Bobcat, the two most imminent issues faced by Doosan Group in 2012 is possible put-back option exercise and debt rescheduling. In addition, Bobcat's operating turnaround is essential to tackle the risks poised by the lossmaking business.

We believe the Bobcat risks will substantially decrease on both financial and operating fronts. First, as the largest shareholder with a 73% stake, Doosan Infracore is in a position to find solutions for the Bobcat problem. Doosan Infracore may elect to sell its stake in DICC and the forklift division to reduce the financial burden. Second, on the operating side, Bobcat should deliver earnings growth after turning from operating losses to operating profits in 4Q10.

Restructuring plan



Source: Doosan Corp., Korea Investment & Securities

(1) Two imminent financial issues

The two most imminent financial issues that Doosan Group must deal with regarding Bobcat are: 1) the USD1.2bn put-back option exercise in December 2012 and 2) rescheduling of debt worth USD2.3bn, which reaches maturity in 2012.

First, in the Bobcat acquisition in 2007, Doosan Group issued USD800mn in preferred stocks to FIs and attached a put-back option guaranteeing a 9% return at maturity (in five years). It appears that Doosan Group will face the put-back option exercise given remote chance of the lossmaking business' stock market listing.

Second, the interest rate is a key area of consideration regarding the rescheduling of USD2.3bn in debt in 2012 and after. Doosan Group borrowed funds at the real interest rate of less than 3% (six-month Libor plus 160-305bp) to complete the Bobcat deal. But unlike in 2007 when it reported stable profits, Bobcat is continues to post net losses and therefore the interest spread will further widen. Each 100bp rise in interest rate will increase Doosan Group's interest expenses by more than W25bn annually.

Doosan Group needs to have at least W1trn on hand to respond to the put-back exercise and to repay the debt at favorable terms.

Put-back option exercise and debt rescheduling

	2012	2013	2014
Put-back option exercise	USD1.2bn (including principal of USD 0.8bn)		
Debt rescheduling	USD0.9bn	USD0.7bn	USD0.7bn
Total	USD2.1bn		

Source: Korea Investment & Securities

(2) Fund raising plan in action

Doosan Infracore (DI) disposed a 20% stake in its wholly owned subsidiary, DICC, in March 2011 to financial investors for W380bn. We believe the stake disposal is Doosan Group's first action to show its strong commitment to remove Bobcat risks prior to the expiration of put-back options at end-2012. Given that Doosan Group should raise at least W1trn to ease concerns related to the put-back option exercise and to get favorable financing terms, we expect additional divestiture of assets such as DI's forklift business and stakes in DICC.

First, DIP Holdings owned by Doosan Corp. is reportedly to take over the forklift business from DI. The disposal of the forklift business to DIP Holdings or non-related parties should generate about W250bn to DI.

Second, more batches of DICC shares should be divested through the IPO. The key issues are when, how, and where DICC will go public. In particular, whether DICC will hold an IPO in Korea or Hong Kong depends on share valuation and amendments to Korea's Monopoly Regulation and Fair Trade Law (MRFTL). Given that Doosan plans to take DICC to public mainly to raise funds, it will choose a place which fetches more proceeds from the IPO. In addition, DICC can go public in Korea only when the national assembly approves the MRFTL revision which relaxes grandchild subsidiary's minimum ownership in great-grandchild subsidiary below the current 100%.

A holding company, Doosan Corp. has DI as a grandchild subsidiary and DICC as a great-grandchild subsidiary[1]. DICC does not belong to the category of overseas subsidiaries that satisfy listing requirements because it runs a CKD assembly operation in China for DI and neither has its own manufacturing business nor serves as a holding company. That is, DICC should seek an IPO in Korea as a domestic company. If such is the case, the company runs into a regulatory hurdle as the grandchild subsidiary is required to own a 100% stake in the great-grandchild subsidiary. But if the national assembly passes amendments to the MRFTL, it will clear the way for DICC's listing in Korea.

DICC shareholding structure change

Pre disposal		Post disposal	
Shareholder	% stake	Shareholder	% stake
Doosan Infracore	90%	Doosan Infracore	80%
Doosan International	10%	FI	20%

Source: Korea Investment & Securities

DICC's earnings

(W bn)

	2008	2009	2010
Net profit	75.7	100.4	145.5

Source: Korea Investment & Securities

We believe Doosan Corp. can raise W1trn-1.3trn to address Bobcat risks when it raises W630bn-W650bn from the sales of a 20% stake in DICC and the forklift business and another 20%-30% disposal of DICC's outstanding shares through the IPO.

(3) Operating turnaround to accelerate restructuring plans

Bobcat's problem began when it reported massive operating losses and therefore could not service its huge debt burden. With this in mind, we believe the key to Bobcat's restructuring lies in its operating turnaround. Without improving its operating results, tackling of the financial issues such as the put-back option exercise and debt rescheduling would be nothing more than stopgap measures.

[1] Although DI has only an 80% stake in DICC, DICC is qualified as a great-grandchild subsidiary because it is an overseas entity.

On a positive note, Bobcat's operating results are continuing to improve, which could accelerate its restructuring plans. Bobcat's EBIDTA and EBIT turned to a profit in 2Q10 and 4Q10, respectively, and we forecast its EBITDA will reach USD210mn in 2011F.

Considering that actual interest expenses amount to USD9mn per month, we expect Bobcat to reach the actual break-even point in 2H11, which allows the company to cover its monthly interest expenses. In particular, the US, Bobcat's mainstay market, has entered an economic recovery phase led by the job market. Bobcat's operating results turnaround will gather pace when the US housing sector, Bobcat's demand market, joins the recovery.

Bobcat's earnings (USD mn)

	1Q10	2Q10	3Q10	4Q10	2008	2009	2010	2011
Sales	365.0	554.0	539.0	634.0	2,678.5	1,350.0	2,092.0	2,600.0
EBITDA	(38.0)	3.0	21.0	34.0	132.0	(266.0)	20.0	210.0
OP	(67.0)	(25.0)	(10.0)	4.0	11.3	(385.0)	(98.0)	
NP	(117.0)	(75.0)	(2.0)	(32.0)	(210.9)	(542.0)	(226.0)	

Note: 2011F earnings are company guidance
Source: Korea Investment & Securities

DIP Holdings spearheads changes in Doosan Group

We expect DIP Holdings to ramp up efforts to sell its stakes in Doosan DST, SRS, and KAI in 2011. DIP Holdings is a restructuring vehicle that Doosan Corp established in 2009 and holds stakes in Doosan DST, Samhwa C&C, SRS, and KAI together with ODIN Holdings, a paper company created by financial investors such as Mirae Asset PEF. Samhwa C&C was disposed in 2010 and works are underway to find buyers for SRS and KAI. According to news reports, DI's forklift business is likely to be sold to DIP Holdings or outside investors.

Even if DIP Holdings takes over the forklift business from DI and there are lingering concerns over indirect support for group companies, the negative impact should be limited for Doosan Corp's shares. The possibility is already in the news and known to investors. Second, DIP Holdings can finance the acquisition of the forklift business through the disposal of its equity stakes, which would not impose a financial burden on Doosan Corp. Third, if DIP acquires DI's forklift division, it would invite financial investors and pay fair price for the buyout deal. It is notable that despite the criticism that DIP Holdings was a channel to bail out group companies, the value of Doosan Corp's stakes in DIP Holdings more than doubled (W623bn vs. acquisition cost: W280bn) over the two years and bolstered Doosan Corp's NAV.

DIP Holdings valuation (%, W bn)

	Stake	Value		2011F NP	2010 NP	2009 NP
Doosan DST	51%	457.6	2011F PER of 11x; major products are armored vehicles and anti-aircraft weapons	81.6	87.1	48
SRS	51%	99.3	2011F PER of 12x; KFC and Burger King operation	16.2	14.4	16.2
Samhwa C&C	24%	30.8	Disposal value of W60bn * 24% stake			
KAI	10%	145.0	30% discount to the OTC price of W23,050	92.4	78.8	90.2
Total		622.8	Excl. W110bn in debt			

Source: Korea Investment & Securities

Changes to recommendation and price target

Company (Code)	Date	Recommendation	Price target
Doosan (000150)	10-02-17	BUY	135,000
	10-08-10	BUY	165,000
	10-09-05	BUY	175,000
	10-10-19	BUY	193,000
	11-01-26	BUY	200,000

Doosan(000150)

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