

POSCO

(005490.KS / 005490 KS)

Rating **OUTPERFORM***
Price (18 Jun 07) 475,500 (W)
Target price (from 480,000) 600,000 (W)[†]
Chg to TP (%) 26.2
Mkt cap (W bn) 41,457.34 (US\$ 44.49)
Enterprise value (W bn) 39,618.17
Number of shares (mn) 87.19
Free float (%) 75.60
52-week price range 481000 - 225000

* Stock ratings are relative to the relevant country index
[†] Target Price is for 12 months

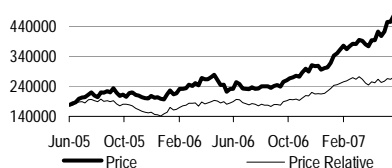
INCREASE TARGET PRICE

FINEX: long-term rerator

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- **Event:** POSCO officially launched its first commercial FINEX plant in May. POSCO's success with FINEX has significant positive implications on long-term competitiveness with structural cost advantage in the upstream production process.
- **View:** While blast furnaces require hard coking coal, FINEX uses inexpensive non-coking coal. A coking plant is a prerequisite for a blast furnace, and coke production is an expensive and highly polluting process. We believe POSCO should be able to get the full benefit by bypassing pre-processing and through the use of cheap raw materials. FINEX, which uses fine ores directly in the furnace, could achieve substantial raw material cost advantages. Overall, we believe the cash margin of the FINEX plant should be at least 13 p.p. higher than that of a blast furnace (plus 20 p.p. higher in the India project).
- **Catalyst:** Fundamentals are still supportive of a favourable cycle and we believe that FINEX-based potential overseas investment in Vietnam and India will be a positive catalyst for the stock.
- **Valuation:** We revised up our FY07 and FY08 earnings estimates by 5.9% and 7.9% to W3,877.4 bn and W4,084.7 bn, respectively, mainly due to better-than-expected pricing trends. Given company-specific structural positives and relative valuation merit, we see more potential upside and maintain our OUTPERFORM rating. We raise our 12-month target price to W600,000, based on 7.3x FY08E EBITDA (the global steel average).

Share price performance



The price relative chart measures performance against the KOREA SE COMPOSITE (KOSPI) index which closed at 1807.85 on 18/06/07

On 18/06/07 the spot exchange rate was W931.80/US\$1

Performance over	1M	3M	12M
Absolute (%)	16.5	24.2	105.0
Relative (%)	4.0	-1.9	43.2

Financial and valuation metrics

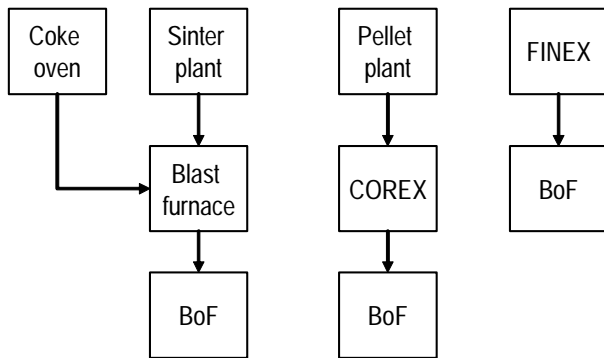
Year	12/06A	12/07E	12/08E	12/09E
Revenue (W bn)	20,043.4	22,363.2	22,584.9	22,566.0
EBITDA (W bn)	5,449.0	6,293.6	6,676.4	6,315.2
EBIT (W bn)	3,892.3	4,743.6	5,026.4	4,775.2
Net income (W bn)	3,206.6	3,877.4	4,084.7	3,915.0
EPS (CS adj., W)	36,778.47	44,472.48	46,842.71	44,897.12
- change from prev. EPS (%)	n.a.	5.9	7.9	8.9
- consensus EPS	n.a.	43,271.50	45,248.21	45,109.93
EPS growth (%)	-20.1	20.9	5.3	-4.2
P/E (x)	12.9	10.7	10.2	10.6
Dividend yield (%)	1.7	1.9	2.1	2.1
EV/EBITDA (x)	7.4	6.3	5.7	5.9
P/B (x)	1.9	1.7	1.5	1.3
ROE (%)	15.5	16.6	15.4	13.3
Net debt/equity (%)	net cash	net cash	net cash	net cash

Source: Company data, Thomson Financial Datastream, Credit Suisse estimates

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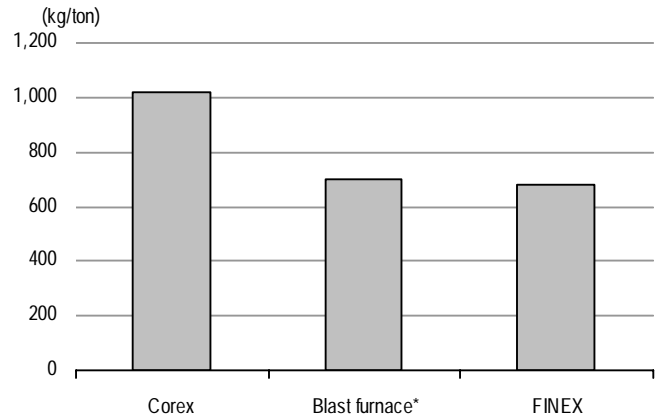
Focus charts

Figure 1: Production method comparison: FINEX, COREX, and traditional blast furnace



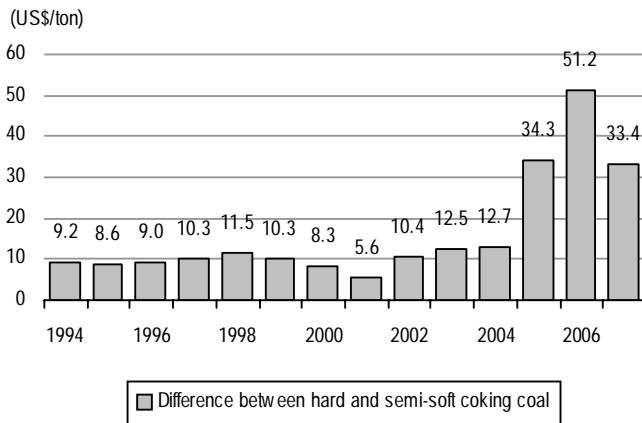
Source: Company data, Credit Suisse estimates

Figure 2: Coal efficiency



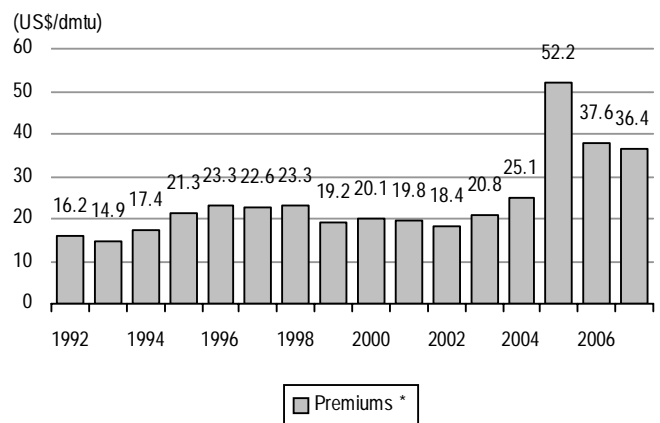
Source: Company data, Credit Suisse estimates

Figure 3: Pricing difference between hard and semi-soft coking coal



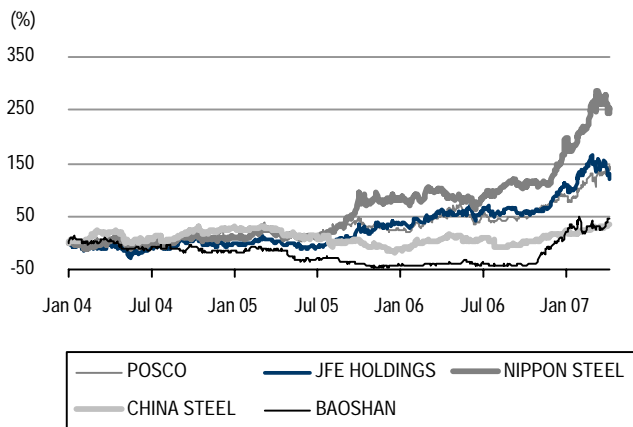
Source: McCloskey, Bloomberg, Credit Suisse estimates

Figure 4: Pricing premium of pellet over fine ore



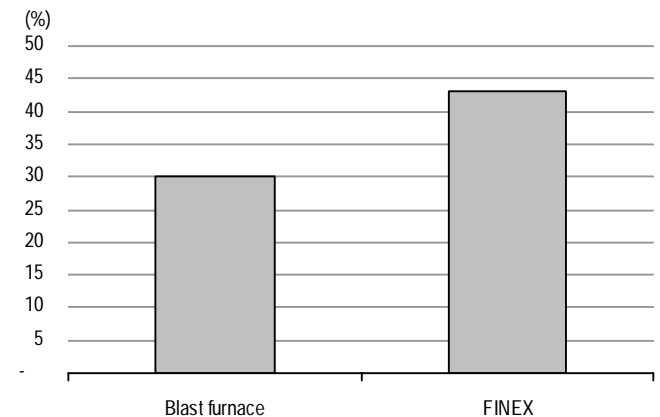
Source: Samarco

Figure 5: Share price performance of major steel mills since Jan 04



Source: DataStream, Credit Suisse estimates

Figure 6: Normalised EBITDA margin (FINEX vs blast furnace)



Source: Company data, Credit Suisse estimates

FINEX: long-term rerator

FINEX across the cycle

The company officially launched its first commercial FINEX plant in May. We believe FINEX is a new solution to the blast furnace problem and COREX technology. FINEX provides the same clean, metallic feedstock as traditional blast furnaces, but costs less and has fewer environmental and fixed-cost disadvantages. The technology FINEX uses appears to be far ahead of that used in existing blast furnaces due to its unparalleled cost advantages. POSCO's success with FINEX has significant positive implications on its long-term competitiveness with structural cost advantages in the upstream production process.

Significant positive implications on long-term competitiveness

We believe the cash margin of a FINEX plant should be at least 13 p.p. higher than that of a blast furnace (plus 20 p.p. higher in the India project). In simple terms, the EBITDA margin from additional overseas capacity could reach approximately 43% (30% normalised margin plus 13% additional value from FINEX). If we assume 17 mn tonnes of overseas capacity, annual EBITDA generation from this capacity could reach W4.0 tn on a normalised basis. We believe this could be a crucial factor in terms of competition, especially when the cycle turns unfavourable.

43% normalised EBITDA margin for potential overseas capacity

Coal economics: inexpensive coal with superior coal efficiency

A blast furnace requires hard coking coal. FINEX uses non-coking coal, as the reduction and melting process occurs in separate furnaces and therefore there are no permeability and strength issues. For a traditional blast furnace, a coking plant is a pre-requisite and coke production is an expensive and highly polluting process. It is possible to build a coking plant with low emissions, but only at high cost. According to POSCO, the coal consumption rate of the FINEX plant reaches 700kg/tonne, which is superior to that of the blast furnace (700-750/t). In addition, POSCO should be able to get the full benefit of bypassing pre-processing and using cheap raw material.

Coal efficiency at par with efficient blast furnace

Iron ore economics: savings from using unprocessed fine ores

Fine ores are the main raw material of FINEX technology. They are less than 8mm in diameter and account for 80% of world iron ore deposits. FINEX, which uses fine ores directly in the furnace, could achieve substantial raw material cost advantages. The advantage of using fine ores increases, if the cost of pellets rises. FINEX has more flexibility in raw material requirements compared to blast furnaces, and is known to operate efficiently even with iron ore which has relatively high alumina/zinc content.

Still attractive, raising our target price to W600,000

We revised up our FY07 and FY08 earnings estimates by 5.9% and 7.9% to W3,877.4 bn and W4,084.7 bn, respectively, to reflect higher than expected average selling price trends. POSCO shares trade at 12.3% and 42.6% discounts to global peers, in terms of EV/EBITDA and P/B, respectively. We raise our 12-month target price to W600,000 based on 7.3x FY08E EBITDA (global steel sector average). Fundamentals are still supportive of a strong cycle, although we are entering the slow summer season. We believe the balance of risk still appears on the upside, given a favourable supply and demand situation in the region. We reiterate our positive view on POSCO, given company specific structural positives and relative valuation merit.

Financial summary

Figure 7: Financial summary

	2003	2004	2005	2006	2007E	2008E	2009E
Income statement							
Sales	14,359.3	19,792.5	21,695.0	20,043.4	22,363.2	22,584.9	22,566.0
Gross profits	3,943.2	6,085.0	6,992.2	5,010.0	5,897.5	6,188.0	5,959.2
Operating profits	3,058.5	5,053.7	5,911.9	3,892.3	4,743.6	5,026.4	4,775.2
Non-operating income	345.9	830.0	746.9	810.9	808.5	807.5	813.4
Non-operating expense	740.5	653.2	1,304.6	584.8	483.6	459.3	437.3
Pre-tax profits	2,663.8	5,233.9	5,354.2	4,118.4	5,068.5	5,374.6	5,151.4
Net income	1,980.5	3,826.0	3,994.6	3,206.6	3,877.4	4,084.7	3,915.0
Balance sheet							
Current assets	5,328	7,742	8,399	7,871	9,014	9,218	9,964
Cash & cash equivalent	2,276	3,564	3,350	3,213	3,874	4,333	4,774
Accounts receivable	1,408	2,006	2,110	1,804	2,072	1,980	1,978
Investment and other assets	4,023	4,059	4,631	5,796	5,796	5,796	5,796
Fixed assets	9,056	9,566	11,177	12,696	14,881	16,856	18,956
Total assets	18,407	21,367	24,207	26,363	29,691	31,870	34,717
Current liabilities	2,528	3,221	3,777	1,747	2,573	2,197	2,547
Accounts payable	426	444	445	520	545	557	649
Short-term debt	925	927	931	10	407	93	44
Long-term liabilities	2,920	2,036	920	2,824	2,254	1,561	1,217
Bond	2,573	1,498	442	2,061	1,465	752	333
Long-term debt	82	58	41	75	163	84	59
Total liabilities	5,449	5,257	4,696	4,571	4,827	3,757	3,765
Shareholders' equity	12,958	16,110	19,510	21,792	24,864	28,113	30,952
Cash flow statement							
Earnings	1,981	3,826	3,995	3,207	3,877	4,085	3,915
Depr. & amort.	1,467	1,467	1,482	1,557	1,550	1,650	1,500
Working capital	-115	-434	-322	-716	-52	192	95
Cash flow from operations	3,623	4,822	5,306	4,025	5,604	5,977	5,560
Capex	-1,113	-2,300	-3,123	-3,088	-3,700	-3,500	-3,600
Cash flow from investment	-2,114	-3,182	-3,293	-3,097	-3,700	-3,500	-4,000
Dividends	-326	-525	-681	-636	-697	-785	-872
Change in LT debt	-649	-1,097	-1,069	731	-110	-1,107	-493
Other	-329	19	-221	-759	-435	-126	-154
Cash flow from financing	-1,301	-1,602	-1,970	-665	-1,243	-2,018	-1,519
Net change in cash	720	-30	52	306	661	459	41
Financial ratio							
Profit margins							
Operating (%)	21.3	25.5	27.2	19.4	21.2	22.3	21.2
Net income (%)	13.8	19.3	18.4	16.0	17.3	18.1	17.3
EBITDA (%)	29.1	32.7	32.3	24.8	28.2	29.2	28.0
Profit growth							
Operating profits (%)	66.8	65.2	17.0	-34.2	21.9	6.0	-5.0
Net income (%)	79.8	93.2	4.4	-19.7	20.9	5.3	-4.2
Per share data (W)							
EPS	21,817	43,883	46,027	36,778	44,472	46,843	44,897
BVPS	142,738	184,773	223,778	249,942	285,176	322,400	354,958
ROA (average assets) (%)	11.1	19.2	17.5	12.7	13.8	13.3	11.8
ROE (%)	16.2	26.3	22.4	15.5	16.6	15.4	13.3
Net debt-to-equity (%)	10.1	-6.7	-9.9	-4.9	-7.4	-12.1	-14.0

Source: Company data, Credit Suisse estimates

FINEX across the cycle

Potential mould breaker in the sector

The company officially launched its first commercial FINEX plant in May. We believe FINEX is a new solution to the blast furnace and COREX technology problem. It provides the same clean, metallic feedstock as traditional blast furnaces, but costs less and has fewer environmental and fixed-cost disadvantages. Technologically, FINEX appears to be far ahead of existing blast furnaces due to its unparalleled cost advantages. We believe FINEX could become the next phase in the development of blast furnace operations. POSCO's success with FINEX has significant positive implications on long-term competitiveness with structural cost advantages in the upstream production process.

New solution to blast furnace technology

We believe a strong commitment from top management is the key to a successful launch of POSCO's FINEX technology. The risk associated with the first-of-its kind technology is something the steel industry generally avoids. Once a new technology has been successfully developed at pilot scale, the greatest challenge is setting up the first commercial plant. With the successful launch of the first commercial plant, we believe the company has made a big step towards strengthening its global cost leadership in the sector.

Key success factors

Developing something like FINEX is a difficult task. In direct smelting, the requirements for successful technology development are extremely demanding. History shows that most failed because they started without strong strategic commitment and support. Persistence, teamwork and most importantly top management's support are the key ingredients of success, in our view. The time scale for developing this type of technology is 15-20 years not 3-5 years. A large scale, expensive pilot plant has been the only way of reducing risk in building a full commercial plant.

Strong commitment was the key for successful launch

Strong low-cost platform for growth

We believe this new FINEX technology should become a strong platform for strengthening POSCO's position in the steel sector. In our view, the company has built the foundation to continue to replicate its success with this new low-cost technology. Regardless of the status of the cycle, FINEX will create positive economic profit based on its cost leadership, in our view. In the long term, FINEX should replace POSCO's old blast furnaces and be the basis for potential investment in India and other Asian countries.

Strong platform for growth

Overcoming drawback of COREX

Among various attempts to develop a new steel making process, COREX has succeeded to the point where multiple commercial plants have been built. The first true commercial plant is POSCO's C2000 plant. COREX may not qualify as a direct smelter, as they do not use iron ore fines directly. COREX's coal consumption rate is around 1,000kg/t which is significantly higher than that of a blast furnace (700-750 kg/t). FINEX has achieved coal efficiency which is comparable to blast furnaces.

FINEX achieved coal efficiency comparable to blast furnaces

Savings in fixed investments

Apart from cost savings from less expensive raw material and processing costs, FINEX reduces fixed investment through bypassing pre-processing plants, such as sintering and coking plants.

Reduced CAPEX burden

- 1) Capex savings: The company believes potential savings could also come from reduced capital investments, as the technology bypasses the sintering and coking

plants. The company estimates the construction cost of FINEX to be about 20% lower than that of blast furnaces.

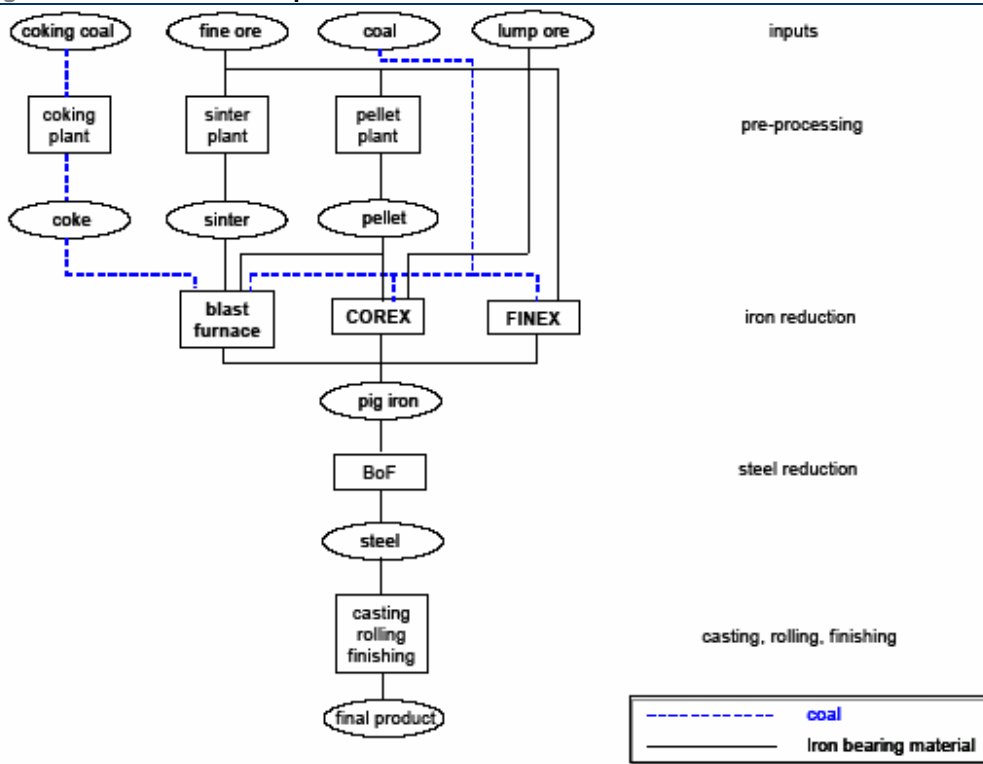
- 2) Maintenance capex is lower than the existing blast furnace operations: We believe the maintenance capex of FINEX is lower than that of blast furnaces due to the reduced production process.
- 3) Achieving economies of scale with smaller capacity: The operation should be more flexible than conventional blast furnaces. The cost of shutdowns and restarts should be much lower than that of blast furnaces, in our view. In contrast to blast furnaces, there is a lower operational cost penalty for under-loaded production.

Estimating FINEX's cost advantage

We believe the cash margin of the FINEX plant should be at least 13 percentage points higher than that of a blast furnace (plus 20 p.p. higher in the India project). Furthermore, we believe this could be a crucial factor in terms of competition, especially when the cycle turns unfavourable. In simple terms, the EBITDA margin from additional overseas capacity could reach approximately 43% (30% normalised margin plus 13% additional value from FINEX). If we assume 17 mn tonnes of potential overseas capacity, annual EBITDA generation from this capacity could reach W4.0 tn on a normalised basis.

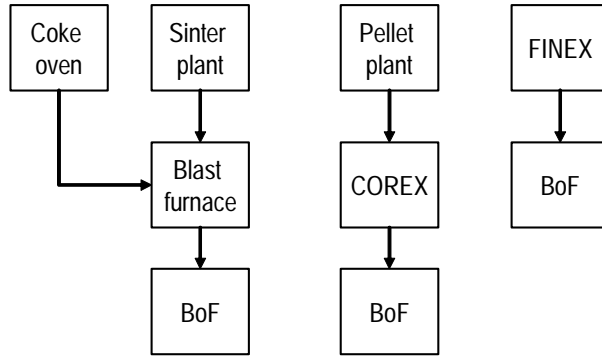
43% normalised EBITDA margin for FINEX-based capacity

Figure 8: Overview of steel production root



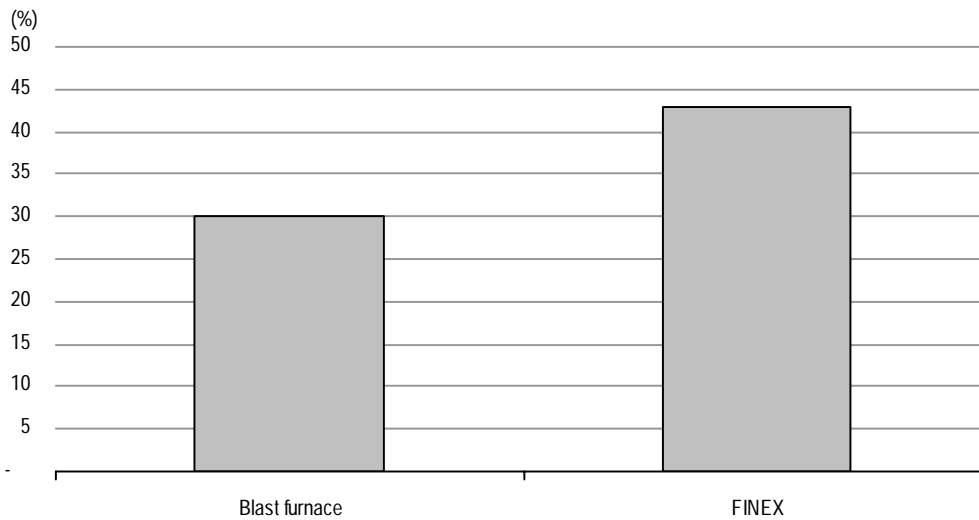
Source: Company data

Figure 9: Production method comparison: FINEX, COREX and traditional blast furnace



Source: Company data, Credit Suisse estimates

Figure 10: Normalised EBITDA margin (FINEX versus blast furnace)



Source: Company data, Credit Suisse estimates

Coal economics: inexpensive coal with superior coal efficiency

Benefits of using inexpensive coal and bypassing the coking process

Blast furnaces require hard coking coal. FINEX uses non-coking coal, as the reduction and melting process occurs in separate furnaces and therefore there are no permeability and strength issues. For traditional blast furnaces, a coking plant is a pre-requisite and coke production is an expensive and highly polluting process. It is possible to build a coking plant with low emissions, but only at high cost. We believe it is likely that with the wearing out of the current generation of coke ovens, the blast furnace will likely yield to alternative processes.

Non-coking coal is the key

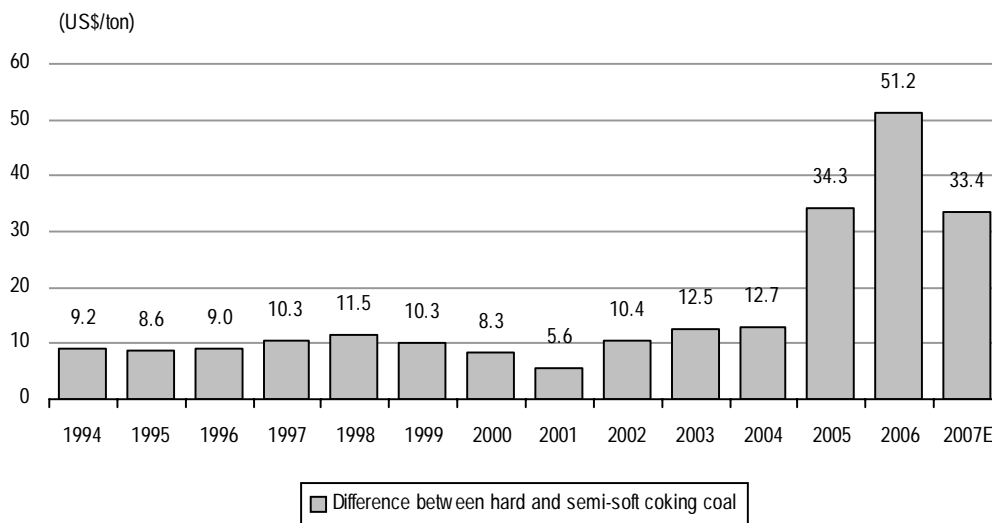
In developed economies, it is highly doubtful steel mills would be allowed to replace the old coking plants due to the environmental issue of the coking process. With emission laws tightening, it is likely that steel mills need to buy more slabs to feed their hot rolling mills in the long term.

Coking is a highly polluting process

The pricing gap between hard coking coal and semi-soft coal has widened significantly, which implies potential savings from the use of cheaper coal could be greater than initial expectation.

Price advantage of non-coking coal

Figure 11: Pricing difference between hard and semi-soft coking coal



Source: McCloskey, Bloomberg, Credit Suisse estimates

Coal requirements: no hard coking coal required

The suitability of coal for coking does not only depend on a sufficient yield, but also on the dilation behaviour during the coking process. During the coking process, the coal volume first increases and then shrinks again. Conventional coke ovens cannot withstand the dilation force of many coals. These specific requirements of coking coal are the cause of their scarcity and relatively high prices. Coke has a porous structure and is the only solid material providing the necessary permeability and structural strength to support the furnace weight burden. FINEX technology uses non-coking coal, as the reduction and melting process occurs in separate furnaces and therefore there are no permeability and strength issues.

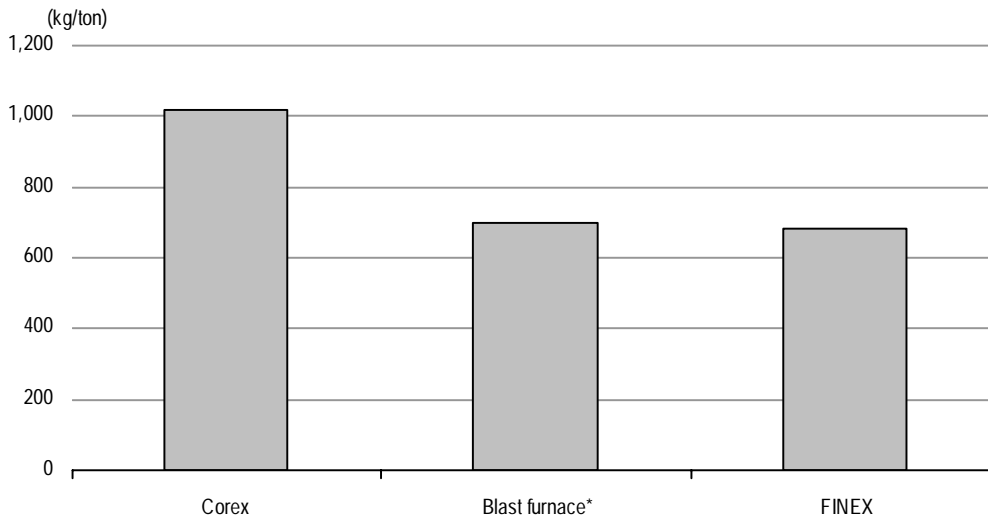
Inexpensive coal is used

Superior coal consumption rate

In developing FINEX, achieving coal efficiency comparable to blast furnaces was the biggest task for POSCO. If a new process has to use more coals for the process, it cannot enjoy the full benefit of using less expensive raw materials. The main drawback of COREX was a high coal consumption rate which reaches around 1,000 kg/t. According to POSCO, the coal consumption rate of the FINEX plant reaches 700 kg/tonne, which is superior to that of a blast furnace (700-750/t), which enables POSCO to get the full benefit of bypassing the pre-processing and using cheap raw material.

Getting the full benefit of bypassing pre-processing and the use of cheap raw material

Figure 12: Coal efficiency

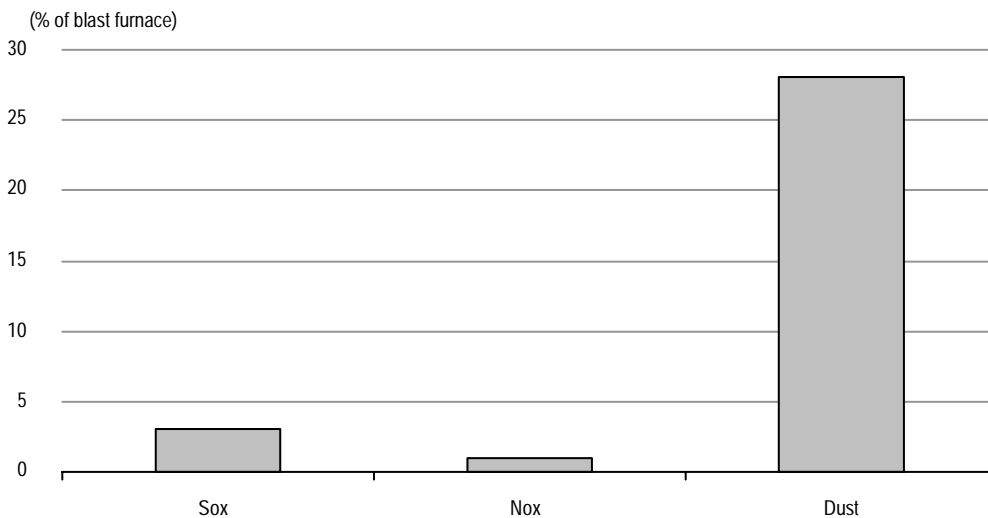


Source: Company data, Credit Suisse estimates

Solution to environmental issues

Given shortened production stages, it is obvious that FINEX has a more environmentally friendly technology than that of traditional blast furnace operations. According to POSCO, its emission of Sox, Nox and dust is significantly lower (3%, 1% and 28% of a blast furnace, respectively) than that of blast furnace operations.

Figure 13: Pollution: Percentage of blast furnace



Source: Company data, Credit Suisse estimates

Iron ore economics: savings from using unprocessed fine ores

FINEX uses fine ore without processing. Lump ore is a suitable feed material for many processes. A main drawback is the high price due to its wide applicability. For most processes, fine ore is not a suitable feed material. However, because of its low price, it is attractive to process fine ore into larger aggregates. These aggregated forms are even better feed material than lump ore. Sintering and pelletising are two common forms of the aggregation process. Iron reduction processes that can use fine ores without processing have significant cost advantages in this respect, as they avoid: 1) processing costs and 2) the purchase of expensive lump ore.

In a typical iron ore mix in a blast furnace, pellet and lump ore comprise about 30%, with the rest being sinter fine. The products are defined by size range: 1) lump ore ranges from 8-50 mm in diameter, 2) fine ores range from 1-8 mm in diameter and 3) pellet fines range from 0-1 mm in diameter.

Further processing required in blast furnace

Fine ores cost about US\$80.9/dmtu F.O.B, while fine pellets are at a discount to sinter fines. However, both are not commercially viable in their original forms because the grain is simply too fine for loading into a blast furnace. Fine ores can be used once they are agglomerated with the addition of coke breeze and limestone by a heating process, known as sintering, which creates larger lumps (known as sinter). Sinter is irregular rocks of 6-25 mm, facilitating the passage of gas flows in the furnace. Sinter is the most important iron-containing material for the blast furnace. The sintering process adds typically US\$4-5/tonne to the cost of the iron ore. The advantage of bypassing the sintering process is obvious, considering the US\$200 mn capex for 3 mn t.p.a.

Fine pellets, on the other hand, go through a more protracted value addition process before they are used. They are ground and concentrated, then palletised in a pellet plant, which effectively roasts fine iron ore and shapes it into pellets. The total conversion cost is around US\$7-10/tonne. The market price for pellets is currently US\$117.28/dmtu, much higher than for other types of iron ores. However, an important drawback of COREX is that it requires expensive pellet or lump ore as an iron source.

Unprocessed ore fines are the way to go

As a result, fine ores are the main raw materials of FINEX technology. Fine ores are less than 8mm in diameter and account for 70% of world iron ore deposits. FINEX, which uses fine ores directly in the furnace, could achieve substantial raw material cost advantages. The advantage of using fine ores increases, if the cost of pellets rises. There is currently limited spare pellet capacity and pellet prices remain at high levels.

We believe FINEX is highly attractive, as it offers significant cost advantages over other types of steel making. In other technologies, such as COREX, iron ores should be in pellets or other larger lumps so than the gas can circulate through the gaps. With FINEX, which uses fluidised bed technology, the iron ore floats in the vessel circulating gas, therefore requiring the use of smaller iron ore, or fine ores.

Flexibility of raw material requirements

FINEX has more flexibility in raw material requirements compared to blast furnaces. In some cases, iron ores which the industry thinks are less desirable to use in traditional blast furnaces could be used in FINEX. FINEX operates efficiently with iron ore which has a relatively high alumina content. The company believes they could overcome iron ore quality issues in some other countries such as India.

Further processing is required in blast furnaces

Unprocessed fine ores: the cheapest route

Fine ore: 70% of world iron ore deposits

More flexible than blast furnace in terms of iron ore requirements

Some technical issues: diameter of fine ores

Fine ores ranges from 0-8 mm. Fine iron ores are supposed to move around in a circular motion with the gas. The problem is that a wide range in density may make it virtually impossible to keep all of the fines in the air at the same time and to keep the coking process even. Some heavier particles could fall and cause clogging, which reduces the uptime in the furnace. In addition, the finest iron ore dust could exit with the gas from the furnace. We believe POSCO's four-step reduction process effectively solved these technical issues.

Overcoming technical issues

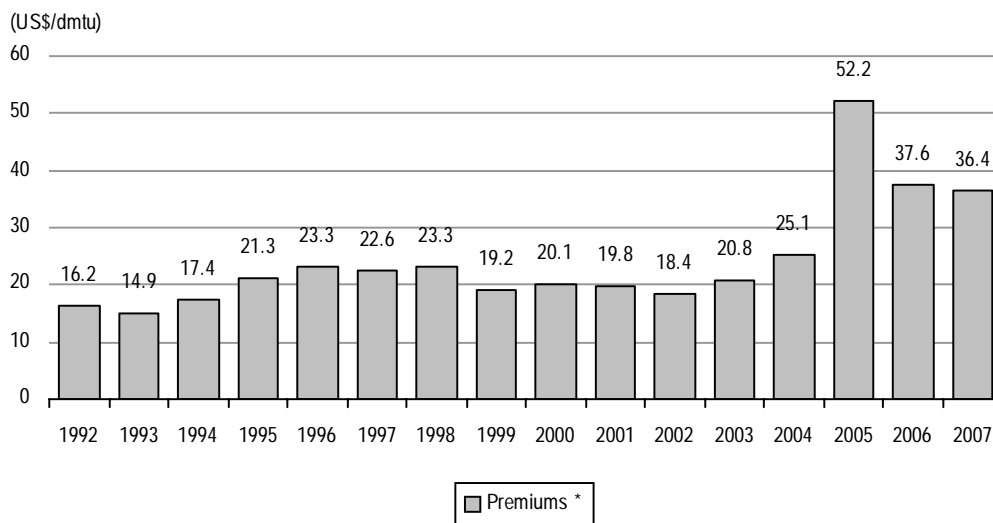
No visible competing technology

There are other technologies under development such as DiOS (Japan), CF, and HIMELT. However, these are either in pilot plant stage or further development was terminated due to technical and financial reasons. We believe the possibility of the emergence of competing technology (commercial plant in mega-modules) seems remote at this stage. One potential drawback of new technology was inferior coal efficiency and utilisation rate but FINEX is achieving superior efficiency compared to blast furnaces.

Some argue that the merits of new technologies have been reduced, as shown below. However, we do not believe such an argument is valid anymore, given what FINEX has achieved in terms of efficiency and cost savings.

- 1) Hard coking coal needed for blast furnace operation. Blast furnace operators are using less hard coking coal and replacing hard coking coal with less expensive soft coking coal. Most importantly, coal efficiency is the key concern for new technology. We believe blast furnace operators have reduced costs by using more soft coal. However, we believe the benefit should be only incremental, given clear limitations of using soft coal in one furnace solution.
- 2) Useful life of coke oven: the useful life of coke oven is not extended up to 50 years from 30-35 years. Coke ovens require huge CAPEX and more importantly have serious environmental issues. We believe it is only a timing issue that highly polluting coke ovens are not likely to be a viable option in many advanced countries in the long term.
- 3) Improved economies of scale of blast furnaces (the inner volume of blast furnaces were enlarged at the time of re-lining).

Figure 14: Pricing premium of pellet over fine ore



Source: Samarco

FINEX and potential overseas investment plan

We believe a FINEX-based overseas investment plan in India and Vietnam makes sense, given: 1) direct access to inexpensive raw materials (captive mine) and 2) a FINEX-based integrated steel mill which overcomes some efficiency issues of some iron ores (alumina content in India). The company remains optimistic about the prospect despite some pending issues in India.

The company plans to begin investing US\$340 mn to start the construction of a cold rolling steel plant scheduled for production in 2009. A second phase is expected to raise the production level to 3 mn tonnes including hot rolled coil. In addition, POSCO will likely finish a feasibility study on building a FINEX based integrated steel plant in Vietnam with Vietnam's biggest shipbuilder, Vinashin Shipbuilding Industry Corp. The potential capacity of this FINEX plant should be around 4-5 mn t.p.a.

In India, Phase I completion is still targeted for 10 Dec but the following issues have to be resolved before construction starts, in our view (India project comprises three phases with total capacity of 12 mn tonnes): 1) Mining Licences: Part of the 2005 MoU between the Orissa government and POSCO included the rights to 600 mn tonnes of iron ore. The government had recommended a prospecting licence for POSCO for the Khandadhar mines in December 2006. Kudremukh Iron, a state-owned company, claims it has already done prospecting, and should get the licence instead. To this effect, it filed a lawsuit in the Orissa High Court (HC). The Orissa High Court has referred it to the Central government 2) Land acquisition: The plan requires 4004 acres of land, of which approximately 90% is government owned. Some 1,135 acres (28%) of government owned land have already been sanctioned. The rest is occupied by encroachers, who are holding up the process. The privately held land houses 450 families and is also posing some difficulties.

FINEX and overseas investment plan: powerful combination for long-term growth

Potential projects in Vietnam and India

Valuation: still attractive

The upgrade in earnings and target price

We revised our FY07 and FY08 earnings estimates upward by 5.9% and 7.9% to W3,877.4 bn and W4,084.7 bn, respectively, to reflect a higher-than-expected ASP trend. Despite continued outperformance, POSCO shares trade at 12.3% and 42.6% discount to global peers, in terms of EV/EBITDA and P/B, respectively. We raise our 12-month price target to W600,000 from W480,000 based on 7.3x FY08E EBITDA, the global steel sector average, (from a previous 6.5x EBITDA).

Figure 15: Earnings revision for 07E and 08E

(W bn)	New		Old		Chg. (%)	
	2007	2008	2007	2008	2007	2008
Revenue	22,363.2	22,584.9	22,081.1	22,305.4	1.3	1.3
OP	4,743.6	5,026.4	4,461.5	4,746.9	6.3	5.9
NP	3,877.4	4,084.7	3,660.1	3,786.4	5.9	7.9

Source: Credit Suisse estimates

Positive view maintained

Fundamentals are still supportive of a strong cycle, although we are entering into the slow summer season. Inventory levels in major steel producing countries still remain low, especially in Japan. We believe the balance of risk still appears on the upside, given a favourable supply and demand situation in the region. POSCO has recently reduced/abolished some price discounts for large customers and there could be some upside potential in some products such as heavy plate in 2H, given continued strength in regional pricing and increasing pricing gap.

Fundamentals remain favourable

We maintain our positive view on POSCO, given company specific structural positives (FINEX combined with potential Indian/Vietnam projects) and valuation merit. We believe POSCO shares should continue to narrow their valuation gap against its peers mainly on the back of increasing visibility in its growth strategy and strengthening long-term competitiveness.

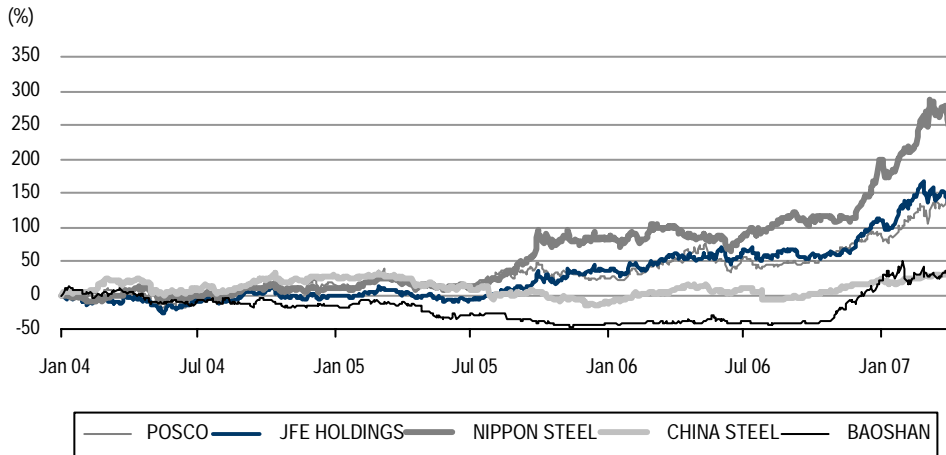
Company-specific structural positives

Figure 16: Valuation comparison to global peers

	EV/EBITDA (x)		P/B (x)	
	2007E	2008E	2007E	2008E
Global top-10 avg.	7.5	6.9	2.9	2.4
POSCO	6.6	6.0	1.7	1.5
Discount (%)	-12.3	-13.8	-42.6	-39.9

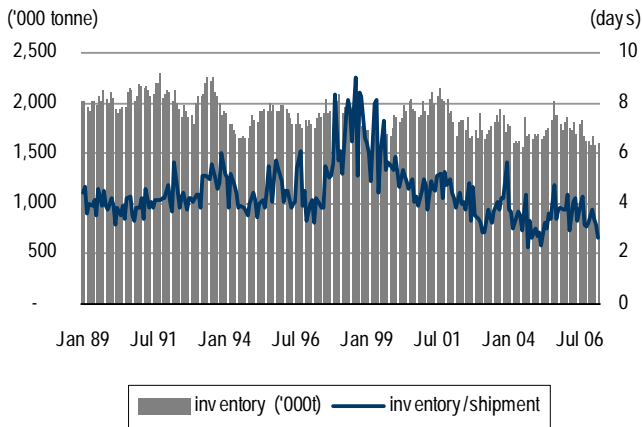
Source: Credit Suisse estimates

Figure 17: Share price performance of major steel mills since January 2004



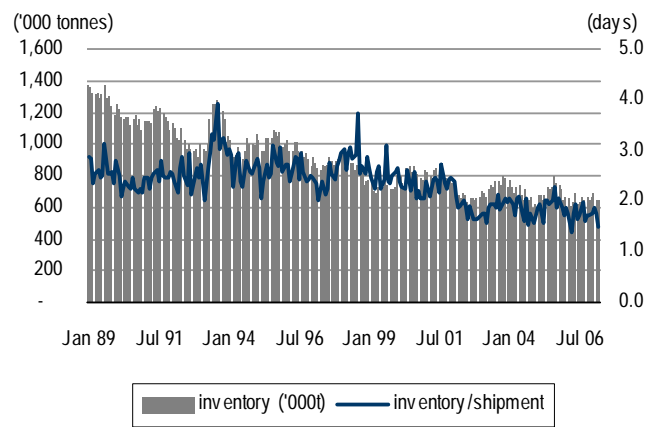
Source: DataStream

Figure 18: Japanese inventory – HRC



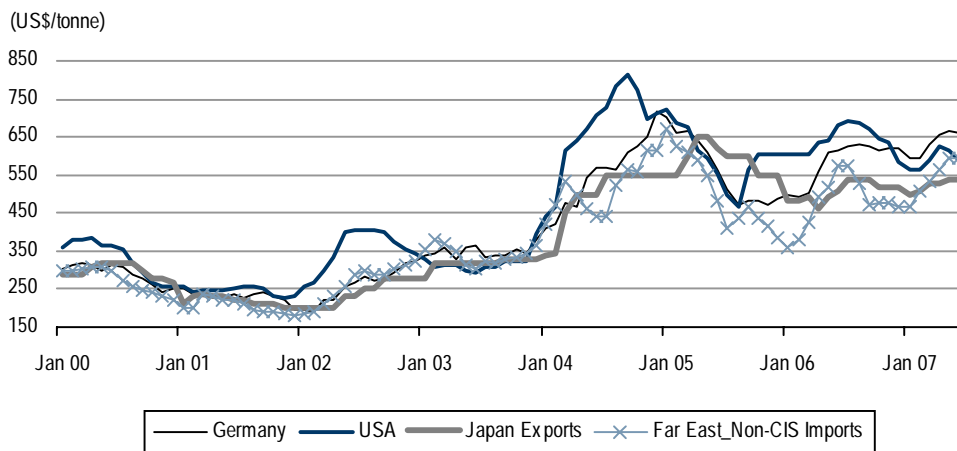
Source: Company data, Credit Suisse estimates

Figure 19: Japanese inventory – CRC



Source: Company data, Credit Suisse estimates

Figure 20: HRC price trend since 2000



Source: CRU, Credit Suisse estimates

Key financials and assumptions

Figure 21: Income statement

Year-end 31 Dec (W bn)	2003	2004	2005	2006	2007E	2008E	2009E
Sales	14,359.3	19,792.5	21,695.0	20,043.4	22,363.2	22,584.9	22,566.0
Cost of goods sold	10,416.1	13,707.5	14,702.8	15,033.5	16,465.6	16,396.8	16,606.8
Gross profits	3,943.2	6,085.0	6,992.2	5,010.0	5,897.5	6,188.0	5,959.2
Gross margins (%)	27.5	30.7	32.2	25.0	26.4	27.4	26.4
SG&A	884.7	1,031.3	1,080.4	1,117.7	1,153.9	1,161.6	1,183.9
Operating profits	3,058.5	5,053.7	5,911.9	3,892.3	4,743.6	5,026.4	4,775.2
Operating margins (%)	21.3	25.5	27.2	19.4	21.2	22.3	21.2
Non-operating income	345.9	830.0	746.9	810.9	808.5	807.5	813.4
Interest received	61.8	79.9	63.3	81.7	104.6	117.0	128.9
Forex gains	72.5	278.1	230.5	189.1	200.0	150.0	150.0
Non-operating expense	740.5	653.2	1,304.6	584.8	483.6	459.3	437.3
Interest expense	215.2	143.8	88.3	78.8	83.6	59.3	27.3
Forex losses	165.6	96.3	87.4	114.1	100.0	100.0	100.0
Recurring profits	2,663.8	5,230.5	5,354.2	4,118.4	5,068.5	5,374.6	5,151.4
Extraordinary income	0.0	3.4	0.0	0.0	0.0	0.0	0.0
Extraordinary loss	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Pre-tax profits	2,663.8	5,233.9	5,354.2	4,118.4	5,068.5	5,374.6	5,151.4
Income tax	683.3	1,407.9	1,359.6	911.8	1,191.1	1,289.9	1,236.3
Effective tax rate (%)	25.7	26.9	25.4	22.1	23.5	24.0	24.0
Net income	1,980.5	3,826.0	3,994.6	3,206.6	3,877.4	4,084.7	3,915.0
YoY (%)	79.8	93.2	21.2	-19.7	20.9	5.3	-4.2
Net margins (%)	13.8	19.3	18.5	16.0	17.3	18.1	17.3
No. of shares	90.8	87.2	87.2	87.2	87.2	87.2	87.2
EPS	21,817	43,883	46,027	36,778	44,472	46,843	44,897
EPS growth (%)	85.4	101.1	21.2	-20.1	20.9	5.3	-4.2

Source: Company data, Credit Suisse estimates

Figure 22: Balance sheet

Year-end 31 Dec (W bn)	2003	2004	2005	2006	2007E	2008E	2009E
Current assets	5,328	7,742	8,399	7,871	9,014	9,218	9,964
Cash & cash equivalent	2,276	3,564	3,350	3,213	3,874	4,333	4,774
Account receivables	1,408	2,006	2,110	1,804	2,072	1,980	1,978
Investment and other assets	4,023	4,059	4,631	5,796	5,796	5,796	5,796
Fixed assets	9,056	9,566	11,177	12,696	14,881	16,856	18,956
Deferred assets	0	0	0	0	0	0	0
Total assets	18,407	21,367	24,207	26,363	29,691	31,870	34,717
Current liabilities	2,528	3,221	3,777	1,747	2,573	2,197	2,547
Account payables	426	444	445	520	545	557	649
Short-term debt	925	927	931	10	407	93	44
Long-term liabilities	2,920	2,036	920	2,824	2,254	1,561	1,217
Bond	2,573	1,498	442	2,061	1,465	752	333
Long-term debt	82	58	41	75	163	84	59
Total liabilities	5,449	5,257	4,696	4,571	4,827	3,757	3,765
Shareholders' equity	12,958	16,110	19,510	21,792	24,864	28,113	30,952
Liab. & shareholders' equity	18,407	21,367	24,207	26,363	29,691	31,871	34,717

Source: Company data, Credit Suisse estimates

Figure 23: Cash flow statement

Year-end 31 Dec (W bn)	2003	2004	2005	2006	2007E	2008E	2009E
Earnings	1,981	3,826	3,995	3,207	3,877	4,085	3,915
Depr. & amort.	1,467	1,467	1,482	1,557	1,550	1,650	1,500
Working capital	-115	-434	-322	-716	-52	192	95
Other	290	-36	153	-23	228	50	50
Cash flow from operations	3,623	4,822	5,306	4,025	5,604	5,977	5,560
Capex	-1,113	-2,300	-3,123	-3,088	-3,700	-3,500	-3,600
Invest. & other assets	-154	-36	-572	-1,166	0	0	0
Marketable securities	-350	-1,318	266	442	0	0	-400
Other	-497	472	135	715	0	0	0
Cash flow from investment	-2,114	-3,182	-3,293	-3,097	-3,700	-3,500	-4,000
Dividends	-326	-525	-681	-636	-697	-785	-872
Shares issued	0	0	0	0	0	0	0
Change in ST debt	3	0	1	0	0	0	0
Change in LT debt	-649	-1,097	-1,069	731	-110	-1,107	-493
Other	-329	19	-221	-759	-435	-126	-154
Cash flow from financing	-1,301	-1,602	-1,970	-665	-1,243	-2,018	-1,519
Net change in cash	720	-30	52	306	661	459	41

Source: Company data, Credit Suisse estimates

Figure 24: Major assumptions

Year-end 31 Dec	2003	2004	2005	2006	2007E	2008E	2009E
Sales volume (mn tonnes)	28.2	29.2	28.7	28.5	29.1	29.1	29.6
Growth (%)	3.7	3.6	-1.9	-0.4	2.0	0.0	1.6
Steel price realisation							
W/tonne	493,008	677,732	738,337	681,487	768,234	775,850	762,911
YoY (%)	14.3	37.5	8.9	-7.7	12.7	1.0	-1.7
US\$/tonne	414	592	731	714	817	825	812
Exchange rate @	1,192	1,145	1,010	955	940	940	940
Raw material per tonne (W)	229,195	327,003	364,734	365,531	404,960	401,963	401,963
% change	12.9	42.7	11.5	0.2	10.8	-0.7	0.0
Raw material price per tonne (US\$)	192	286	356	357	431	428	428
Operating cash cost							
W/tonne	349,573	455,877	499,854	512,629	551,895	549,418	549,406
US\$/tonne	293	398	495	537	587	584	584
EBITDA per tonne (US\$)	120	194	236	177	230	241	227
EBITDA margin (%)	29.1	32.7	32.3	24.8	28.2	29.2	28.0
EBITDA (US\$ mn)	3,393	5,659	6,767	5,048	6,700	7,012	6,718
EBITDA (W bn)	4,045	6,479	6,835	4,820	6,298	6,591	6,315
Number of employees	19,276	19,276	19,276	19,276	19,276	19,276	19,276

Source: Company data, Credit Suisse estimates

Companies Mentioned (Price as of 19 Jun 07)

Baoshan Iron & Steel (600019.SS, RMB11.40, UNDERPERFORM, TP RMB6.40)
 China Steel (2002.TW, NT\$38.90, NEUTRAL, TP NT\$27.20)
 JFE Holdings Inc (5411, ¥7,640, UNDERPERFORM, TP ¥6,300, UNDERWEIGHT)
 Nippon Steel (5401, ¥879, NEUTRAL, TP ¥780, UNDERWEIGHT)
 POSCO (005490.KS, W475,500, OUTPERFORM, TP W600,000)

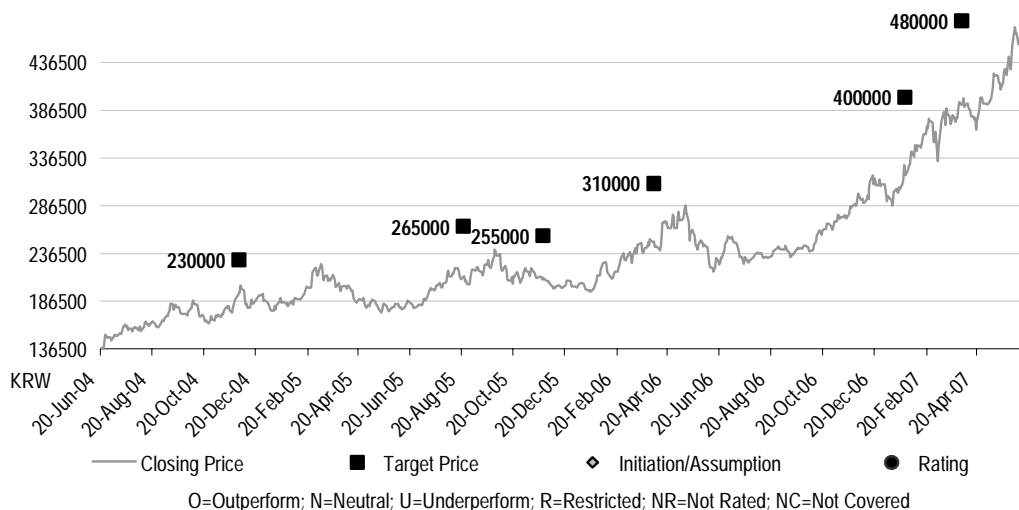
Disclosure Appendix

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3-Year Price, Target Price and Rating Change History Chart for 005490.KS



005490.KS Date	Closing Price Price (KRW)	Target Price Price (KRW)	Rating	Initiation/ Assumption
30-Nov-04	195500	230000		
22-Aug-05	212500	265000		
24-Nov-05	211000	255000		
4-Apr-06	249000	310000		
25-Jan-07	323500	400000		
2-Apr-07	392000	480000		

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Price Target: (12 months) for (005490.KS)

Method: Our W600,000 target price for POSCO is based on 7.3x FY08E EBITDA (global steel average multiple) from previous 6.5x EBITDA and 2.1x book value. POSCO currently trades at 11.3% and 41.6% discount to global peers in terms of EV/EBITDA and P/B, respectively. We believe POSCO shares should continue to narrow its valuation gap against peers, given strengthening cost competitiveness across the cycle.

Risks: The primary risk to our W600,000 target price for POSCO is an potential economic downturn in China and global economies, which would have a negative impact on our forecasts for this heavy commodity-oriented company. Demand growth in emerging markets are the key factor for sector fundamentals alongwith continued global consolidations wave.

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