

POSCO (005490)

A String of Favorable News

■ POSCO and Nippon Steel Deepen Alliance, Tata Steel Acquires Corus

POSCO announced its plan to deepen its strategic alliance with Japan's Nippon Steel, bolstering up its cross-shareholding arrangement. This was following the news of Tata Steel's acquisition of Corus, the world's ninth largest steelmaker. Strategic alliance and large-scale M&As, following the Mittal Steel and Arcelor deal, are likely to bolster POSCO's share price.

■ Future Steel Industry to be determined by Baoshan's 1Q07 Domestic Steel Prices

Since China is the world's largest steel maker, the domestic steel prices announced by Baoshan Iron & Steel (China's largest steel producer) are likely to determine the future direction of the steel industry. 1Q07 prices are scheduled to be announced in mid-November. It is likely that prices will be frozen due to the recent rebound in steel prices in CIS and China.

Price negotiation for raw materials will be finalized in March, 2007. Iron Ore prices are expected to be slightly higher or remain unchanged. POSCO's operating profit margin of approximately 20% in 3Q06 is likely to continue until 2Q07.

■ Maintain Overweight with a Target Price of W290,000

Global steel prices rebounded, led by the Commonwealth of Independent States (CIS) and China, while spot prices in China remained strong. Therefore, it is highly likely that Baoshan Iron & Steel will freeze domestic prices for 1Q07. However, POSCO's share price may be negatively affected by the expected global imbalance in supply and demand starting 2H07, declining operating profits, and a less attractive valuation.

However, we expect POSCO's shares to be bolstered by solid earnings projected until 1H07, expansion of Nippon Steel's stake in POSCO by 2% (1.74mn shares), and the M&A activity between the global steel companies. Thus, POSCO is expected to slightly outperform the market.

Overweight

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Bloomberg: 005490 KS

Reuters: 005490.KS

Target price (6M): W290,000

Share Price (20/10/06): W261,000

Par Value: W5,000

52-W Lo/Hi: W192,000/284,500

KOSPI: 1,364.2p

Mkt Cap: US\$23.8bn/W22,755.8bn

Shares Issued: 87.2 mn shr

Avg Volume (60D): 259,596 shr

Avg Value (60D): US\$61.8mn/W59.2bn

Foreign Ownership: 62.1%

Dividend Yield (2005): 4.0%

Major Shareholder(s):

Bank of New York (27.38%)

SK Telecom (2.85%)

Price Performance

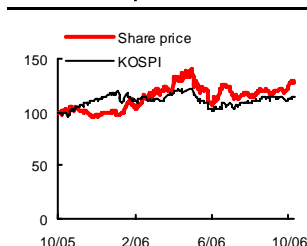
(%)	1M	6M	12M
Absolute	8.5	-0.2	27.5
Relative	8.7	4.7	10.1

Forecasts/Valuations

FY	Sales (Wbn)	OP (Wbn)	NP (Wbn)	EPS (W)	yoy (%)	FCF (Wbn)	ROE (%)	P/E (x)	P/B (x)	EV/EBITDA (x)
12/04	19,792.5	5,053.7	3,826.0	43,180	97.1	2,920.9	26.3	4.3	1.0	2.3
12/05	21,695.0	5,911.9	4,012.9	46,027	6.6	2,318.0	22.5	4.4	0.9	2.1
12/06F	19,848.4	3,842.1	3,080.9	35,337	-23.2	226.5	15.1	7.4	1.1	4.0
12/07F	20,103.5	3,590.4	2,612.2	29,961	-15.2	-201.5	11.6	8.7	1.0	4.1
12/08F	21,065.4	3,381.5	2,399.0	27,516	-8.2	-159.9	9.8	9.5	0.9	4.2

Source: Company data, Daewoo Securities

KOSPI Relative performance Chart



Content

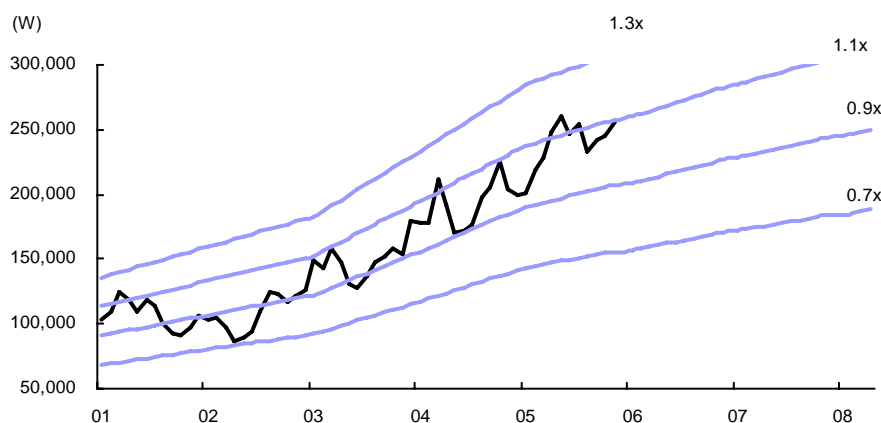
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MAINTAIN OVERWEIGHT WITH A TARGET PRICE OF W290,000

We maintain Overweight on POSCO with a target price of W290,000. Investment points are as follows:

- 1) Operating profit in 4Q06 is likely to remain flat qoq at the W1tr level as the amount of production and ASP is expected to remain constant. We also expect operating profit margins to remain flat qoq, reaching 20.1% in 4Q06F.
- 2) Domestic steel plate prices are expected to be raised W30,000~50,000 per tonne, as Dongkuk Steel already raised steel plate prices by W50,000 on October 16. We do not expect changes in the hot-rolled or cold-rolled coil prices, as the price of hot-rolled coil imported from Japan was settled at US\$520 (FOB) in 4Q06, which is similar to POSCO's domestic price of W520,000 or approximately US\$540.
- 3) Operating profit is expected to gradually decline during 2007~2008F, given that global steel manufacturers are planning to double or triple their production capacity by 2010. If Baoshan Iron & Steel does not change domestic steel prices in 1Q07, POSCO's profitability will remain strong until 1H07.
- 4) The expansion of its tie-up with Nippon Steel will provide a boost to its corporate value and share price. The acquisition of a 2% stake (1.74mn shares) in POSCO by Nippon Steel will positively affect its share price, and the alliance between the No. 1 and 2 companies in Asia will help POSCO to strategically enhance its competitive edge amid the ongoing consolidation in the global steel industry.
- 5) The M&A activity between Mittal Steel and Arcelor, and Tata and Corus may initially seem unfavorable. As POSCO's major competitors grow larger in size, their production capacity will increase, negatively affecting POSCO. However, it will help to stabilize the steel market going forward, as it will enable better control of the amount of steel production and stronger negotiation of prices.
- 6) POSCO's share price is anticipated to be restrained by the global imbalance of supply and demand, declining operating profits, and a less attractive valuation. However, its share price is expected to outperform the market, thanks to solid earnings until 2Q07F, M&A between large steel manufacturers around the globe, and the expansion of Nippon Steel's stake in POSCO.

Chart 1. POSCO's P/B band



Source: Daewoo Securities

DEEPER ALLIANCE WITH NIPPON STEEL, AND M&A BETWEEN TATA AND CORUS IS POSITIVE NEWS

1. Expansion of Strategic Alliance with Nippon Steel (NSC)

The Board of Directors approved the strengthening of the strategic alliance with Nippon Steel on October 20. Specifics of the tie-up include mutual exchange of slabs, cooperation in recycling ferruginous by-products, and an increase in cross shareholdings. The alliance will develop into other areas going forward, including a joint investment to procure raw materials.

First, POSCO and Nippon Steel are planning to supply steel slabs to each other. They will exchange 200,000 tonnes of slabs from February 2007 to March 2008, as a total of six blast furnaces are scheduled for repair.

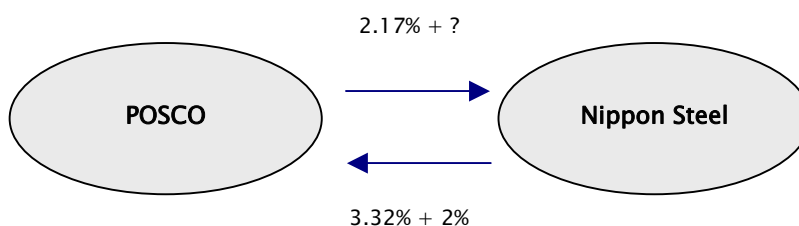
Second, they will cooperate in recycling ferruginous by-products. POSCO is planning to build rotary hearth furnaces (RHF), developed and used by Nippon Steel, at the iron mills in Pohang and Gwangyang. The new facilities will recycle the ferruginous by-products created during the iron and steel manufacturing process into a raw material.

Third, they will expand their capital alliance by increasing their cross shareholdings. Nippon Steel will buy an additional 2 percent stake (1.74mn shares) in POSCO, while POSCO will spend the equivalent amount to increase their stake in Nippon Steel. Currently, POSCO has a 2.17 percent stake in Nippon Steel, while Nippon Steel owns 3.32 percent of POSCO.

The exchange of steel slabs and the sharing of RHF technology will be beneficial, as it will provide stability to their operations from the efficient use of each other's facilities, a reduction in by-product disposal costs, and stronger environmental protection.

The strengthened alliance will help both companies to grow and enhance their corporate value. Increasing friendly shares will be especially meaningful for POSCO, given its large foreign shareholding of 62.1%. The stronger relationship will also help to defend the Asian steel market from the global giant, Mittal Steel, which recently acquired Arcelor.

Chart 2. Cross Shareholdings between POSCO and Nippon Steel



Source: Companies data, Daewoo Securities

2. Tata Steel of India Acquires Corus Group

Corus Group, the world's ninth largest crude steel manufacturer in 2005, recently accepted the takeover bid by Tata Steel of India. According to England's BBC news, the Anglo-Dutch steelmaker, Corus, agreed on the £4.1bn or \$7.7bn offer from Tata Steel. Corus had been in talks with Russia's Severstal and Brazil's Companhia Siderurgica Nacional before securing the Tata deal.

Corus was formed out of the 1999 merger of British Steel and Dutch group Hoogovens. It produced 1.82 million tonnes of crude steel in 2005, ranking as the world's ninth largest crude steel manufacturer. Mittal Steel, which was formed out of an M&A between Ispat of India and the International Steel Group of the U.S., is assumed to have had considerable influence on Tata Steel's decision to go through with the M&A.

Tata-Corus will become the sixth largest steel company in the world once the output of 18.2 million tonnes by Corus is added to Tata's output of 5 million tonnes. The merger will benefit both companies, as Corus will be able to overcome difficulties arising from high manufacturing costs and Tata will now become a major player.

The Tata-Corus deal occurring soon after the merger of Mittal-Arcelor, is not considered positive news for the global steel industry due to concerns of overcapacity. Mittal-Arcelor plans to increase its production capacity from 110 million tonnes to 200 million tonnes, while production capacity is expected to double or triple from China (five major blast furnaces), POSCO, Nippon Steel, JFE, and Baoshan by 2010.

Wall Street analysts have recently picked US Steel as the most attractive M&A target among global steel manufacturers. Steel makers no longer have a choice but to expand its own production capacity or participate in an M&A.

Consolidation in the global steel industry is expected to accelerate now that the Mittal-Arcelor and the Tata-Corus deals have gone through. Consolidation will positively affect the steel industry in the sense that companies will have greater control over the amount of steel production and hold greater leverage in negotiating prices. However, serious risks of a supply glut lies ahead.

Table 1. Changes to global steelmaker rankings

(mn tones)	1999	2002	2004	2005	Production volume	2007F	Production volume
1	POSCO	Arcelor	Arcelor	Mittal Steel	49.9	Mittal Arcelor	109.7
2	Nippon Steel	Mittal Steel (LNM)	Mittal Steel (LNM)	Arcelor	46.7	Nippon Steel	32.9
3	Arbed	Nippon Steel	Nippon Steel	Nippon Steel	32.9	POSCO	31.4
4	Usinor	POSCO	JFE (NKK+ Kawasaki)	POSCO	31.4	JFE	29.6
5	Corus	Baosan Steel	POSCO	JFE	29.6	Baosan Steel	23.8
6	Mittal Steel (Ispat)	Corus	Baosan Steel	Baosan Steel	22.7	Tata Corus	22.6
7	Baosan Steel	Thyssel Krupp	US Steel	US Steel	19.3	US Steel	19.3
8	Thyssen Krupp	NKK	Corus	Nucor	18.5	Nucor	18.5
9	Riva	Riva	Nucor	Corus	18.2	Riva	18.2
10	NKK	US Steel	Thyssen Krupp	Riva	17.5	Thyssen Krupp	16.5

Source: IISI, Daewoo Securities

CHECKPOINTS: 1Q STEEL PRICE IN CHINA SET BY BAOSHAN

The global steel market will be significantly influenced by China's domestic prices for 1Q07, which Baoshan Iron & Steel will announce in mid-November. China is the largest steel producer in the world, and Baoshan Iron & Steel is the China's biggest steelmaker. We expect Baoshan to maintain the current price, as global steel prices have stopped declining and spot prices remain strong in China.

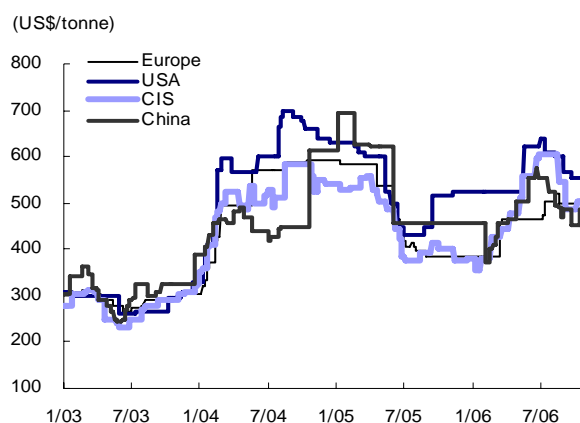
The price of hot-rolled coil is at around US\$520 in Korea, China, and Japan. With the recovery of steel prices in CIS (Commonwealth of Independent States), Baoshan Iron & Steel is highly likely to maintain its current domestic price in the first half of 2007.

Table 2. Hot-rolled coil price comparison by country

	Korea	Japan	China
Price	W520,000 (US\$540)	US\$520	US\$520
Company	POSCO	Nippon Steel, JFE Steel	Baoshan Steel
Price based on selling price	Domestic	Exports (4Q)	Domestic (4Q)
Remarks	Cold-roll mills	Free-on-board based	Value-added tax 11% inc.

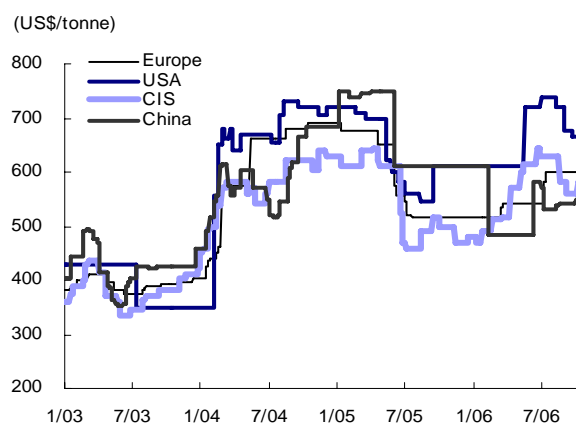
Source: Companies data, Daewoo Securities

Chart 3. Global hot-rolled coil price trend (international trade)



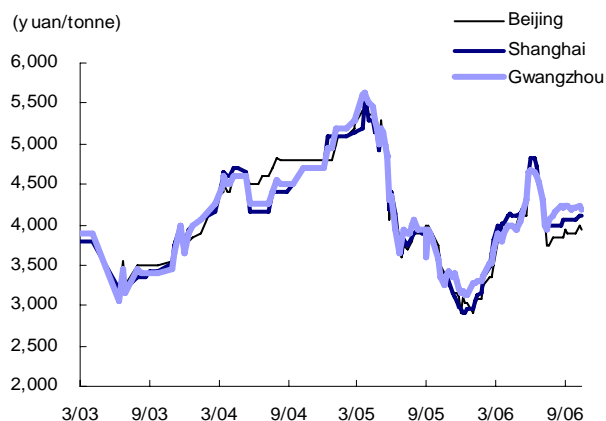
Note: * Commonwealth of Independent States.

Chart 4. Global cold-rolled coil price trend (international trade)



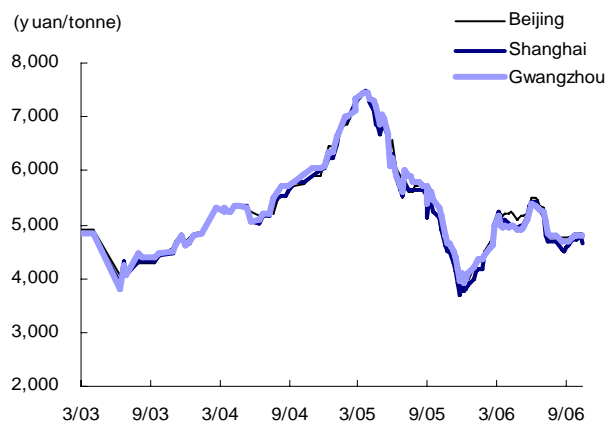
Note: * Commonwealth of Independent States.

Chart 5. Hot-rolled sheet spot price trend in China



Source: Thomson Datastream, Daewoo Securities

Chart 6. Cold-rolled sheet spot price trend in China



Source: Thomson Datastream, Daewoo Securities

EXPECTED HIGH OP MARGIN TILL 2H07

Compared to the previous year, POSCO's sales and operating profit went down to W5,297.7tr and W1,064.3tr in 3Q06. But sales and operating profit increased by 13.4% and by 13.1% from the previous quarter, backed by a 3.3%–9.3% increase in the domestic price of some steel products (up 8.3% for hot-rolled coil, 6.4% for steel from mini mills, and 3.4% for cold-rolled coil) on July 13.

Its good performance was attributed to the rise in production and sales by 6.1% and 4.9%, respectively, thanks to the completion of repair works for its Pohang facility. In 3Q06, average selling price of hot-rolled coil was at W517,000 (up 7.7% qoq), cold-rolled coil at W601,000 (up 4.5%), and STS at W2,486,000 (up 25.2%).

Without additional repair plans, earnings in 4Q06 are expected to have similar performance as the third quarter. If Baoshan cuts its domestic price in 4Q, POSCO's sales may decline and its export prices may be modestly lower. But OP margin is expected to be similar to 3Q at 20.1%.

The high OP margin between 2004–2005 was due partly to strong demand from China, or the "China Effect." POSCO's operating profit—which reached its peak in 2005—is expected to be on a downward trend as the world's top steelmakers are aggressively expanding their production capacity by two to three times the current level by 2010.

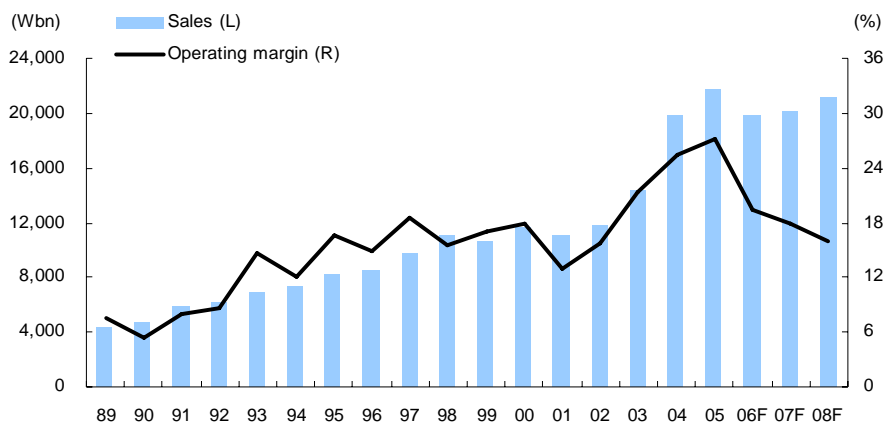
Still, POSCO's OP margin is likely to be higher than in the past. In particular, if Baoshan does not cut its domestic price for 1Q07 and iron ore price negotiations result in only a modest increase or a freeze, POSCO is likely to maintain strong profitability into 2Q07.

Table 3. Quarterly earnings forecasts for 2006

(Wbn)	1Q05	2Q05	3Q05	4Q05	1Q06	2Q06	3Q06P	4Q06F	% yoy	% qoq
Sales	5,655.8	5,378.0	5,458.2	5,203.0	4,663.7	4,672.4	5,297.7	5,114.5	-2.9	13.4
Operating profit	1,776.0	1,728.1	1,319.4	1,088.3	789.9	941.5	1,064.3	1,046.4	-19.3	13.1
Recurring profit	1,824.8	1,718.9	1,383.6	426.8	886.6	897.3	1,165.3	1,117.0	-15.8	29.9
Net profit	1,307.5	1,262.3	1,061.6	381.5	681.4	709.7	880.0	809.8	-17.1	24.0
Operating margin (%)	31.4	32.1	24.2	20.9	16.9	20.2	20.1	20.1	-	-

Source: Company data, Daewoo Securities

Chart 7. POSCO's sales and operating margin trends and forecasts



Source: Company data, Daewoo Securities

REFERENCE: STOCK PRICE TREND OF GLOBAL STEELMAKERS

Stock prices of global steelmakers have gained in line with the bullishness of U.S. steel stocks, which were lifted by the upbeat outlook for the industry as well as the strong possibility of a merger between Tata Corus and US Steel.

Chart 8. Share performances of leading blast furnaces in Korea, US and Japan

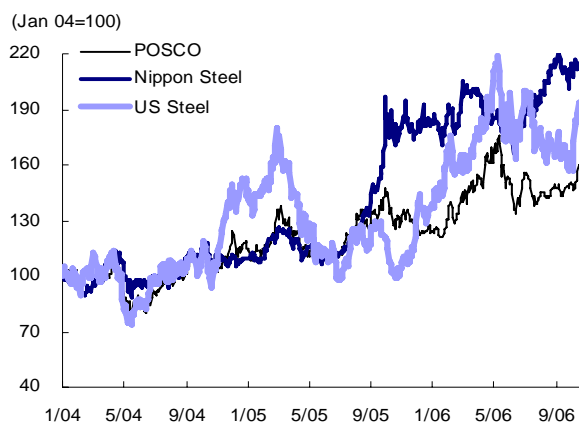


Chart 9. Share performances of leading blast furnaces in Korea, Taiwan and China

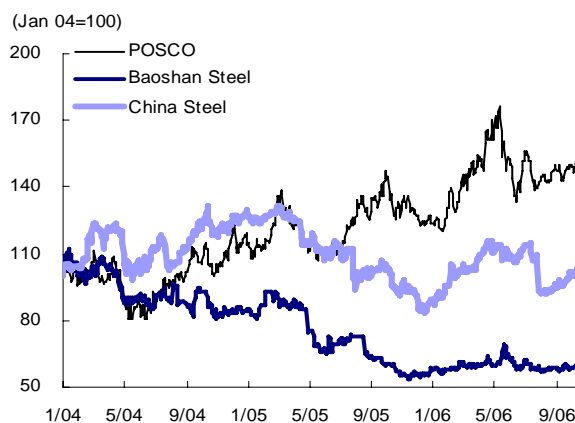


Chart 10. Share performances of leading blast furnaces in Europe

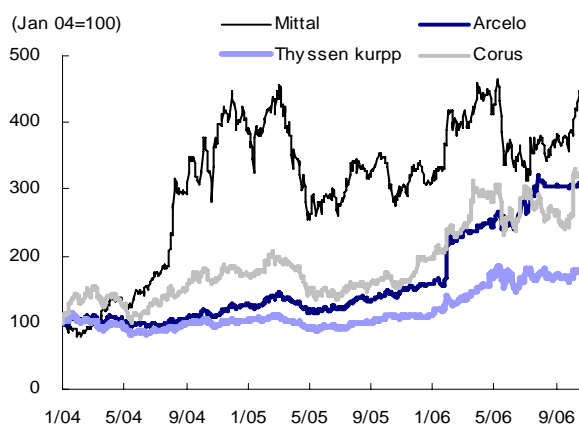


Chart 11. Share performances of leading blast furnaces in China

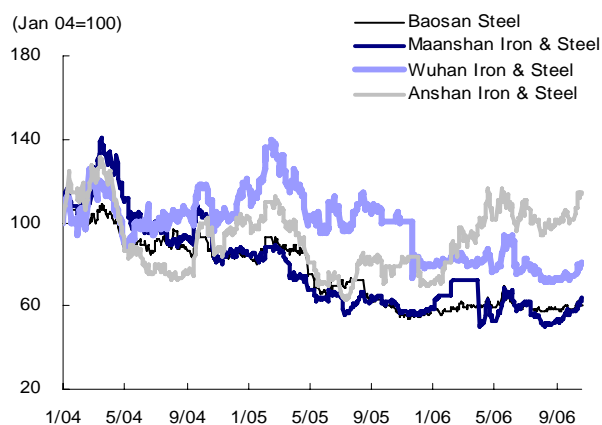


Chart 12. Share performances of leading electric furnaces in Korea, US and Japan

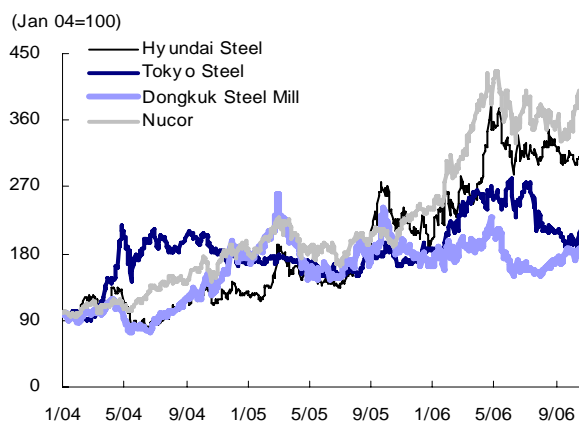
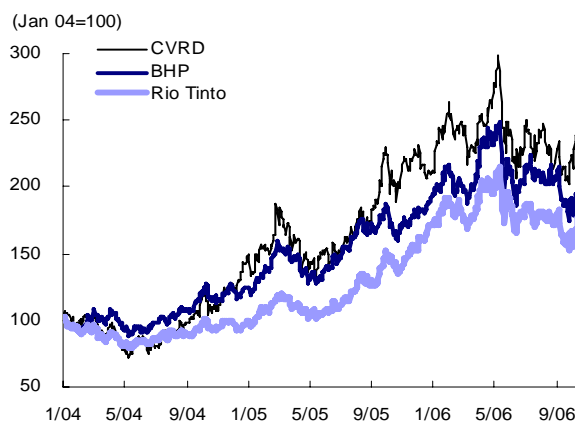


Chart 13. Share performances of world's big-three iron ore miners



Source: Thomson Datastream, Daewoo Securities

Source: Thomson Datastream, Daewoo Securities

POSCO (005490) - Financial Statement

Balance Sheet (Summarized)

(Wbn)	12/05	12/06F	12/07F	12/08F
Current assets	8,399.5	7,285.2	7,232.5	7,292.2
Cash and cash equivalents	249.6	926.9	1,046.0	998.9
Short-term financial goods	3,100.9	1,995.7	1,958.1	1,951.2
Accounts receivable	2,110.3	1,668.7	1,674.6	1,719.7
Inventories	2,718.8	2,503.0	2,364.2	2,427.7
Other current assets	219.8	191.0	189.6	194.7
Non-current assets	15,807.5	18,642.0	21,832.7	24,600.1
Investment assets	4,630.9	5,246.9	5,505.8	5,729.9
Tangible assets	10,898.7	13,167.3	16,149.3	18,742.8
Intangible assets	277.9	227.7	177.6	127.4
Total assets	24,206.9	25,927.2	29,065.1	31,892.3
Current liabilities	3,776.6	2,268.3	2,268.9	2,315.0
Accounts payable	444.6	542.3	551.6	566.5
Short-term borrowings	0.0	96.0	96.0	96.0
Current portion of long-term debt	931.4	460.3	460.3	460.3
Other current liabilities	2,400.6	1,169.6	1,161.0	1,192.2
Non-current liabilities	908.3	2,227.2	3,218.4	4,222.0
Bonds	441.8	1,636.4	2,636.4	3,636.4
Long-term debt	41.1	35.1	35.1	35.1
Other non-current liabilities	425.5	555.7	546.9	550.5
Total liabilities	4,684.9	4,495.5	5,487.4	6,537.0
Capital stock	482.4	482.4	482.4	482.4
Surplus	20,071.4	22,513.9	24,660.1	26,437.5
Capital adjustments	-1,031.8	-1,564.7	-1,564.7	-1,564.7
Total stockholders' equity	19,522.0	21,431.7	23,577.8	25,355.3

Cash Flow (Summarized)

(Wbn)	12/05	12/06F	12/07F	12/08F
Cash flow from operating activities	5,306.4	3,950.3	4,415.4	4,404.4
Net profit	4,012.9	3,080.9	2,612.2	2,399.0
Non-cash income and expense	1,773.6	1,292.7	1,670.4	2,075.2
Tangible assets depreciation	1,481.6	1,649.8	1,984.5	2,373.0
Intangible assets depreciation	0.0	0.0	0.0	0.0
Others	292.0	-357.1	-314.2	-297.8
Chg in assets & liabilities from oper. activities	-480.2	-423.3	132.8	-69.9
Chg in accounts receivable	-105.9	434.3	-8.1	-47.2
Chg in inventories	-613.5	215.9	138.8	-63.6
Chg in accounts payable	-160.6	98.1	9.3	14.8
Others	-4,387.2	-1,171.6	-7.2	26.1
Cash flow from investment activities	-3,293.3	-2,999.7	-4,941.4	-4,913.5
Disposal (acquisition) of tangible assets	-3,078.3	-3,884.9	-4,966.6	-4,966.6
Reductions (growth) in intangible assets	-12.5	13.6	50.2	50.2
Tangible assets investment	-440.9	-248.9	1.1	-4.1
Others	238.5	1,120.4	-26.2	6.9
Cash flow from financing activities	-1,970.3	-273.3	645.1	462.1
Chg in bonds and borrowings	-939.0	833.8	1,000.0	1,000.0
Chg in equity	-1,032.1	-1,238.7	-466.1	-621.5
Dividends	-680.8	-638.4	-466.1	-621.5
Others	3.4	131.5	111.2	83.6
Chg in cash	42.9	677.3	119.1	-47.1
Beginning cash balance	206.8	249.6	926.9	1,046.0
Ending cash balance	249.6	926.9	1,046.0	998.9

Income Statement (Summarized)

(Wbn)	12/05	12/06F	12/07F	12/08F
Sales	21,695.0	19,848.4	20,103.5	21,065.4
Cost of goods sold	14,702.8	14,965.5	15,479.7	16,641.7
Gross profit	6,992.2	4,882.9	4,623.8	4,423.7
SG&A expenses	1,080.4	1,040.8	1,033.4	1,042.2
Operating profit	5,911.9	3,842.1	3,590.4	3,381.5
Non-operating profit	-557.7	224.1	12.7	-72.6
Interest income/expenses	-25.0	3.8	-6.5	-55.9
FX-related gains/losses	143.1	114.2	56.3	80.0
Equity method gains/losses	46.9	366.3	260.0	220.0
Asset disposal gains/losses	-133.5	9.2	0.0	0.0
Other non-operating profit/losses	-589.1	-269.4	-297.1	-316.7
Recurring profit	5,354.2	4,066.3	3,603.1	3,309.0
Extraordinary gains/losses	0.0	0.0	0.0	0.0
Pretax profit	5,354.2	4,066.3	3,603.1	3,309.0
Tax	1,341.3	985.3	990.8	910.0
Net profit	4,012.9	3,080.9	2,612.2	2,399.0
Free cash flow	2,318.0	226.5	-201.5	-159.9
Residual income	4,012.9	3,080.9	2,612.2	2,399.0
EBITDA	7,393.5	5,492.0	5,574.9	5,754.6
Depreciation of tangible/intangible assets	1,481.6	1,649.8	1,984.5	2,373.0
Gross margin (%)	32.2	24.6	23.0	21.0
EBITDA margin (%)	34.1	27.7	27.7	27.3
Operating margin (%)	27.3	19.4	17.9	16.1
Recurring margin (%)	24.7	20.5	17.9	15.7
Net margin (%)	18.5	15.5	13.0	11.4

Forecasts/Valuations (Summarized)

	12/05	12/06F	12/07F	12/08F
P/E (x)	4.4	7.4	8.7	9.5
P/CF (x)	3.2	4.8	5.0	4.8
P/S (x)	0.8	1.1	1.1	1.1
P/B (x)	0.9	1.1	1.0	0.9
P/EBITDAPS (x)	2.4	4.1	4.1	4.0
EV/EBITDA (x)	2.1	4.0	4.1	4.2
EPS (W)	46,027	35,337	29,961	27,516
CFPS (W)	63,020	54,260	52,723	54,733
SPS (W)	248,834	227,654	230,579	241,612
BPS (W)	220,723	243,201	268,391	289,354
EBITDA per share (W)	84,801	62,991	63,943	66,003
Dividend payout ratio (%)	15.9	15.1	23.8	25.9
Dividend ratio (%)	160.0	160.0	160.0	160.0
Dividend yield (%)	4.0	3.3	3.3	3.3
Debt-to-equity ratio (%)	24.0	21.0	23.3	25.8
Current ratio (%)	222.4	321.2	318.8	315.0
Borrowings/equity (%)	7.2	10.4	13.7	16.7
Net borrowings/equity (%)	-9.9	-3.2	1.0	5.0
Net borrowings/sales (%)	-8.9	-3.5	1.1	6.1
Net interest expenses/sales (%)	0.1	0.0	0.0	0.3
Interest coverage (x)	67.0	46.1	28.8	19.8
ROA (%)	17.6	12.3	9.5	7.9
ROE (%)	22.5	15.1	11.6	9.8
ROIC (%)	35.4	19.4	15.3	12.4

As of October 24, 2006, Daewoo Securities Co., Ltd. has been acting as a financial advisor to POSCO for its treasury stock trust, and other than this, Daewoo Securities has no other special interests in the companies covered in this report.

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This report is a translation excerpt of the 'POSCO' report written by Ki In Yang for research division of Daewoo Securities Co., Ltd publicly released on October 23, 2006.

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Ratings Distribution

Investment ratings	Target return
Overweight	Relative performance of +15% or greater
Trading Buy	Relative performance of +10% or greater, but with variability/volatility
Equal-weight	Relative performance of -10% and +10%
Underweight	Relative performance of -10%

Note: 1) Our investment rating is a guide to the relative return of the stock versus the market over the next six months.

2) Although it is not part of the official ratings at ERII, we may call a trading opportunity in case there is a technical or short-term material development.

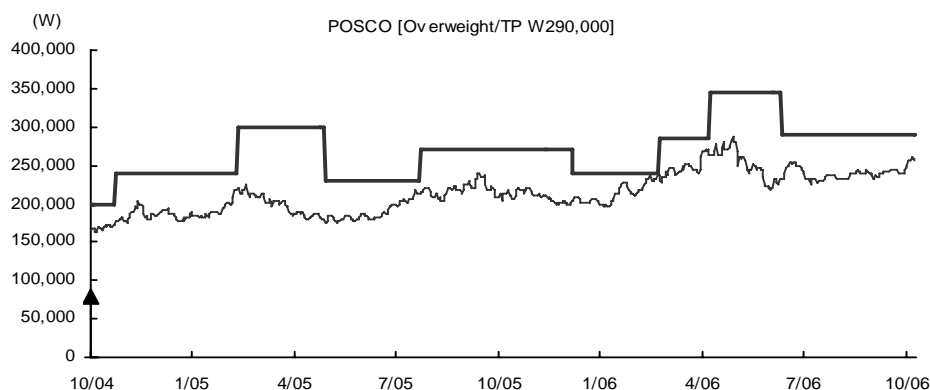
Source: Daewoo Securities

Analyst Industry Ratings of ERII, Daewoo Securities

Positive	Industry fundamentals are improving
Neutral	Industry fundamentals are steady without any material changes
Negative	Industry fundamentals are worsening

Ratings and Target Price History

Share price (-----), Target price (-----), Not covered (⊞), Buy (○), Overweight (▲), Trading Buy (■), Equal-weight (●), Under-weight (◆)



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