

### Irene Kim

irene.kim@cls.com  
(82) 23978437

### Steve Chung, CFA

(82) 23978455

10 August 2010

## Korea

### Miscellaneous

Reuters 037440.KQ  
Bloomberg 037440 KQ

#### Priced on 9 August 2010

Korea Kospi @ 1,790.2

12M hi/lo 14,135/7,100 won

12M price target 12,000 won

±% potential +53%

Target set on 10 Aug 10

Shares in issue 12.9m

Free float (est.) 59.6%

Market cap US\$94m

#### 3M average daily volume

0.6bn won (US\$0.5m)

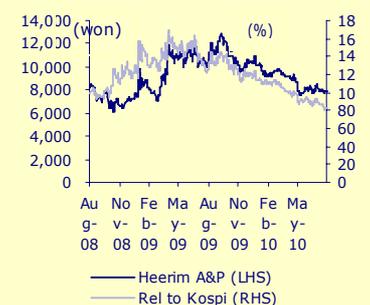
#### Major shareholders

Jeong, Young-Kyoon and related  
40.4%

Foreign s'holding 10.4%

#### Stock performance (%)

	1M	3M	12M
Absolute	(6.4)	(9.8)	(23.4)
Relative	(10.0)	(17.0)	(32.6)
Abs (US\$)	(3.6)	(10.2)	(19.2)



Source: Bloomberg

www.cls.com

## 2Q10 results

Heerim reported 40.5bn won in revenue for 2Q10, up 5%, which was below our forecast of 44.4bn won by 9%. Revenue recognition is still taking time to recover especially in domestic design. Bad debt expense of 1.7bn won drove down OP by 26% to 3.1bn won, again below our expectations by 11%. However, new orders continue to be strong, growing by 47% YoY at 60bn won. Reflecting 2Q10 results, we have revised up our earnings slightly for this year and have lowered them by 5% for next year. This brings down our target price from 12,600 won to 12,000 won. Maintain BUY with 53% upside.

### Topline and margin lower than expected

Heerim recorded 40.5bn won in revenue in 2Q, up only 4.8% and below our forecast of 44.4bn won by 9%. While domestic design was weaker YoY, overseas and Construction Management (CM) increased YoY. Overseas recognition is finally picking up but domestic construction sentiment still seems weak. OP was down 26% at 3.1bn won while we were expecting 3.5bn won. This was mainly due to bad debt expense of 1.7bn won and a high base. FX gains of 0.8bn won helped RP up 4.6% YoY, which was above our forecast by 15%. Revenue is still not showing great signs of pick up.

### New orders better than expected, up 47% YoY

New orders for 2Q10 were 60bn won, above our forecast of 53bn won. Overseas orders were sluggish though, getting only one CM project from Vietnam. We expect good orders going forward, forecasting a total of 309bn won or 55% YoY growth (they have already captured 188bn won). These new orders will be a source of future growth. Backlog is up 36% YoY at 463bn won.

### Earnings change

While it is taking time for sales to recover due to the weak domestic and overseas construction/property market, we believe 2H will start to show recovering sales and profit due to the strong new order trend. We have adjusted our earnings to reflect results; this year sales down 3.7%, net profit up 1% and next year sales down 4.7% and earnings down 5.7%.

### BUY with 53% upside

Due to its strong growth prospects, we believe it deserves a 14x forward PE, and TP of 12,000 won. We have rolled forward our earnings by 1Q using 1Q this year and 3Q next. We have also increased the number of shares by 6% reflecting a change in the CB conversion price. Trading at 11.5x 10CL and 8x 11CL, we believe it deserves a higher value. Maintain BUY with 53% upside.

### Financials

Year to 31 Dec	08A	09CL	10CL	11CL	12CL
Revenue (bn won)	155.84	157.90	181.51	232.18	294.95
Net profit (bn won)	15.79	8.72	10.21	14.17	19.44
EPS (won)	1,229.4	601.7	679.9	943.8	1,294.7
CL/consensus(5)(EPS%)	-	-	101	98	-
EPS (% YoY)	(18.0)	(51.0)	12.9	38.8	37.1
PEx (@7,840 won)	6.7	12.2	11.6	8.1	5.5
Dividend yield (%)	4.1	2.6	3.1	3.6	3.8
FCF yield (%)	(7.3)	3.7	(1.0)	17.8	20.6
ROAE (%)	30.8	15.0	16.1	17.7	19.4
Price/book (x)	1.8	1.4	1.3	1.3	1.1
Net gearing (%)	(4)	12	18	(18)	(30)

Source: CLSA Asia-Pacific Markets

**Topline and margin lower than expected but orders +47%**

Heerim recorded 40.5bn won in revenue in 2Q, up only 4.8% and below our forecast of 44.4bn won by 9%. While domestic design was weaker YoY, overseas and CM increased YoY. Overseas recognition is finally picking up but domestic construction sentiment still seems weak. OP was down 26% at 3.1bn won while we were expecting 3.5bn won mainly due to bad debt expense of 1.7bn won and a high-base. FX gains of 0.8bn won helped RP up 4.6% YoY, which was above our forecast by 15%. Revenue is still not showing great signs of pick up. New orders in 2Q10 amounted to 60bn won, above our forecast of 53bn won. Overseas orders were sluggish though, getting only one CM project from Vietnam. We expect good orders going forward, forecasting a total of 309bn won or 55% YoY growth (Heerim has already achieved 188bn won in orders). These new orders will be a source for future growth. Backlog is up 36% YoY at 463bn won.

Figure 1

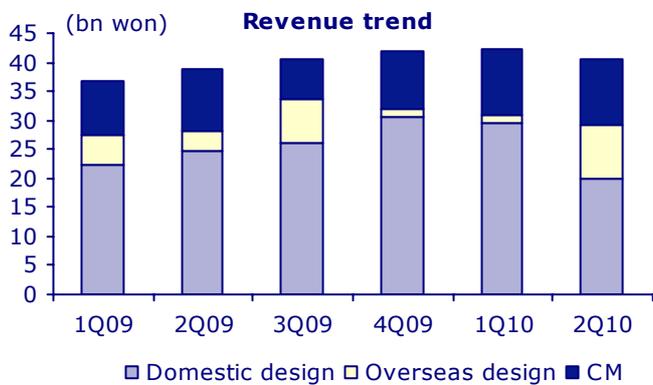
**2Q10 results summary**

(bnwon)	2Q10	2Q09	YoY%	1Q10	QoQ%	CLSA	vs. CL%	Cons	vs. Cons%
Sales	40.5	38.6	4.8	42.4	(4.5)	44.4	(8.8)	46.9	(13.5)
OP	3.1	4.1	(26.0)	3.1	(0.1)	3.5	(12.9)	4.9	(37.3)
RP	3.4	3.3	4.6	2.3	49.4	3.0	14.7	4.5	(23.6)
NP	1.9	1.5	25.1	2.3	(15.8)	1.6	23.1	3.1	(37.5)

Source: CLSA Asia-Pacific Markets

Figure 2

**Quarterly revenue**



Source: CLSA Asia-Pacific Markets

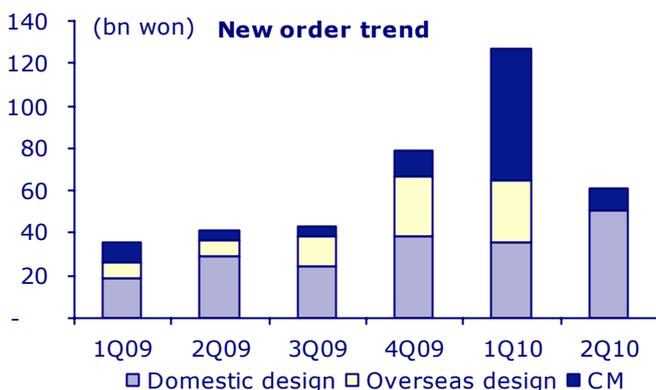
Figure 3

**Quarterly operating profit margin**



Figure 4

**New order trend**



Source: CLSA Asia-Pacific Markets

Figure 5

**Backlog trend**

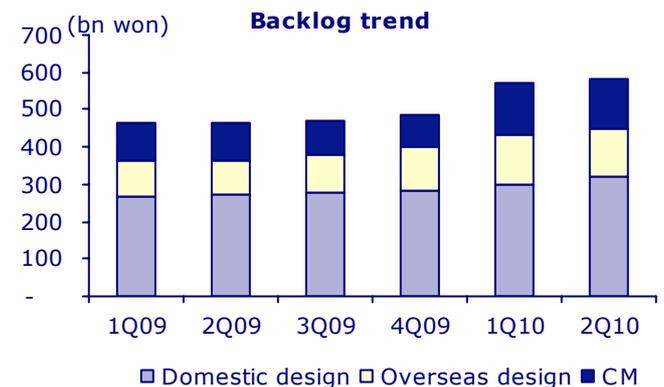


Figure 6

**Forecast change**

(bn won, %)	2010CL			2011CL		
	New	Old	Change%	New	Old	Change%
Sales	181.5	188.5	(3.7)	232.2	243.8	(4.7)
OP	15.2	16.0	(5.3)	20.5	21.5	(4.7)
OPM	8.4	8.5	(0.1)	8.8	8.8	0.0
NP	10.21	10.12	0.9	14.2	15.0	(5.7)
NPM	5.6	5.4	0.3	6.1	6.2	(0.1)
New order	308.5	300.7	2.6	343.8	335.1	2.6
TP	12,000	12,600	(4.8)			
Last close (Aug 9)	7,800.0					
Upside	54%					

Source: CLSA Asia-Pacific Markets

While it is taking time for sales to recover due to the weak domestic and overseas construction/property market, we believe 2H will start to show recovering sales and profit due to the strong new order trend. We have adjusted our earnings to reflect the results: this year sales down 3.7%, and net profit up 1% and next year sales down 4.7% and earnings down 5.7%.

Figure 7

**Target valuation**

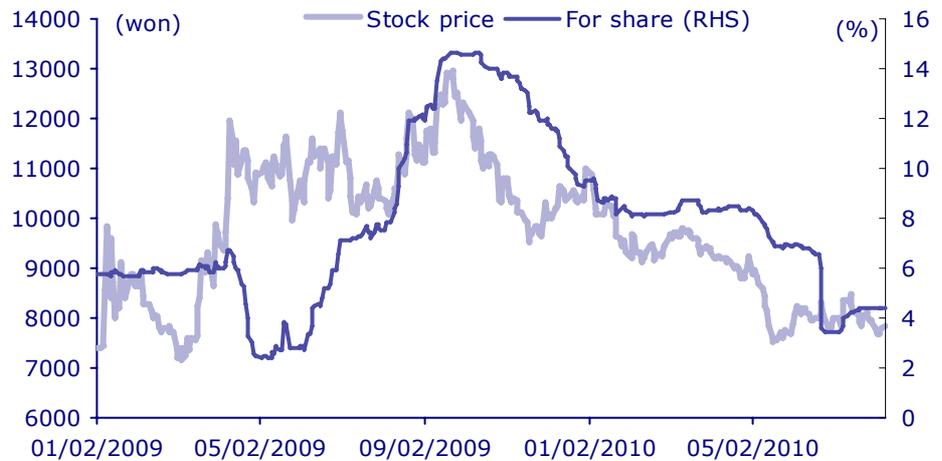
<b>Beta</b>	<b>0.75</b>
Risk Free Rate	5.0%
Equity Risk Premium	7.0%
Cost Of Equity	10.3%
Payout Rate for 5 years	30.0%
Growth rate 5 years	20%
Stable Payout rate	55%
Stable Growth rate	3.0%
PE ratio first 5 yrs	1.9
Topline	1.4
Bottom Line	0.1
Terminal PE	12
Total PE	14
2010/2011EPS	878
TP on 14x	12,000
Last close	7,840
Upside	53%

Source: CLSA Asia-Pacific Markets

Due to the strong growth prospects, we believe it deserves a 14x forward PE, which gives a target price of 12,000 won. We have rolled forward our earnings base by 1Q using 1Q this year and 3Qs next. We have also increased the number of shares by 6% reflecting the change in the CB conversion price. Trading at 11.5x 10CL and 8x 11CL, we believe it deserves a higher value. Maintain BUY with 53% upside.

Figure 8

**Stock price vs. foreign ownership**



Source: CLSA Asia-Pacific Markets

Figure 9

**Major new orders in 1H10**

Date	Client	Project	Project Amount (m won)
14-Jan-10	Incheon City Asian Games Support Co	2014 Incheon Asian Games Stadium design	3,286
19-Jan-10	Gangeum Corp	China Gangeum Hotel CM	8,400
21-Jan-10	Pie City	Yangjae Pie City CM	6,004
10-Feb-10	Hanoi Real Estate business and services	Mixed use residential apartments	2,932
26-Feb-10	State Oil Company of Azerbaijan	Azerbaijan State Oil Company Office building CM	9,596
2-Mar-10	National Bank Limited (Bangladesh)	National Bank Limited(NBL) Tower design & CM	21,793
2-Mar-10	Pinewood Foundation Inc Phillipinne Manila	Broadcast Complex Project design	26,851
4-Mar-10	EX development	Yeosu Hotel-resort design and CM	7,433
16-Apr-10	Kogas	Kogas HQ design	2,960
21-Apr-10	Chungra Intl business town	Chungra Intl business town Block C1&2 design	5,390
29-Apr-10	Vietnam govt	Vietnam Mofa HQ CM	3,309
6-May-10	Lotte E&C	Busan Lotte Town stage 3&4 design	4,620
10-May-10	KORAIL Corp	Station design	1,651
17-May-10	MKE technology standard corp	HQ design	1,324
7-Jun-10	Kepeco	Kepeco INGS Campus CM	1,183

Source: CLSA Asia-Pacific Markets

**Summary P&L forecast (wonbn)**

Year to 31 December	2008A	2009CL	2010CL	2011CL	2012CL
<b>Revenue</b>	<b>156</b>	<b>158</b>	<b>182</b>	<b>232</b>	<b>295</b>
Operating Ebitda	18	16	18	24	31
Operating Ebit	16	13	15	21	27
Interest income	0	0	0	0	0
Interest expense	0	(1)	(1)	(1)	0
Other items	4	(1)	(1)	(2)	(2)
<b>Profit before tax</b>	<b>20</b>	<b>12</b>	<b>14</b>	<b>19</b>	<b>26</b>
Taxation	(5)	(3)	(3)	(5)	(6)
Minorities and other	0	0	0	0	0
<b>Profit</b>	<b>16</b>	<b>9</b>	<b>10</b>	<b>14</b>	<b>19</b>

**Summary cashflow forecast (wonbn)**

<b>Operating Ebit</b>	<b>16</b>	<b>13</b>	<b>15</b>	<b>21</b>	<b>27</b>
Depreciation/amort	2	3	3	4	4
Working capital - trade	(27)	(15)	(18)	(5)	(10)
Other operating items	6	7	5	4	0
<b>Operating cashflow</b>	<b>(3)</b>	<b>8</b>	<b>5</b>	<b>24</b>	<b>21</b>
Net interest/taxes/other	(1)	(1)	(1)	0	0
<b>Cashflow</b>	<b>(4)</b>	<b>7</b>	<b>4</b>	<b>24</b>	<b>22</b>
Capital expenditure	(3)	(3)	(2)	(3)	(3)
Acq/inv/disposals	7	(6)	(3)	(6)	0
<b>Free Cashflow</b>	<b>0</b>	<b>(2)</b>	<b>(1)</b>	<b>16</b>	<b>19</b>
Ord div paid/Other items	(4)	(8)	(4)	13	(3)
Decrease in net debt	(4)	(10)	(5)	29	16

**Summary balance sheet forecast (wonbn)**

Cash & equivalents	2	8	3	16	32
Debtors - trade	44	60	80	93	119
Inventories - trade	0	0	0	0	0
Other current assets	3	9	2	2	(1)
Fixed assets	10	10	10	12	13
Intangible assets	5	4	5	5	5
Other term assets	10	11	16	22	22
<b>Total assets</b>	<b>75</b>	<b>102</b>	<b>117</b>	<b>150</b>	<b>189</b>
Short-term debt	0	0	0	0	0
Creditors - trade	0	0	0	0	0
Other current liabs	16	25	31	39	52
Long-term debt/CBs	0	15	15	0	0
Other long-term liabs	2	3	3	18	30
Minorities/other equity	0	0	0	0	0
Shareholder funds	56	60	67	93	108
<b>Total liabs &amp; equity</b>	<b>75</b>	<b>102</b>	<b>117</b>	<b>150</b>	<b>189</b>

**Ratio analysis**

Revenue growth (%)	29.7	1.3	15.0	27.9	27.0
Op Ebitda growth (%)	27.0	(11.4)	13.3	33.4	29.1
Op Ebit growth (%)	26.9	(15.1)	13.5	35.1	32.7
Op Ebitda margin (%)	11.7	10.2	10.1	10.5	10.7
Op Ebit margin (%)	10.1	8.5	8.4	8.8	9.2
Net profit margin (%)	10.1	5.5	5.6	6.1	6.6
Dividend payout (%)	26.0	33.2	29.4	26.5	23.2
Tax rate (%)	22.5	27.2	24.9	24.2	24.2
Ebitda/net int exp (x)	(45.9)	60.9	17.3	135.4	(82.2)
Net debt/equity (%)	(4.4)	11.8	18.1	(17.6)	(30.0)
Gross debt/equity (%)	0.0	25.1	22.3	0.0	0.0
Net debt/op Ebitda (x)	(0.1)	0.4	0.7	(0.7)	(1.0)
Gross debt/op Ebitda (x)	0.0	0.9	0.8	0.0	0.0
Return on equity (%)	30.8	15.0	16.1	17.7	19.4
ROCE (%)	42.6	20.3	20.0	24.2	33.2
Return on assets (%)	24.0	9.9	9.3	10.6	11.4

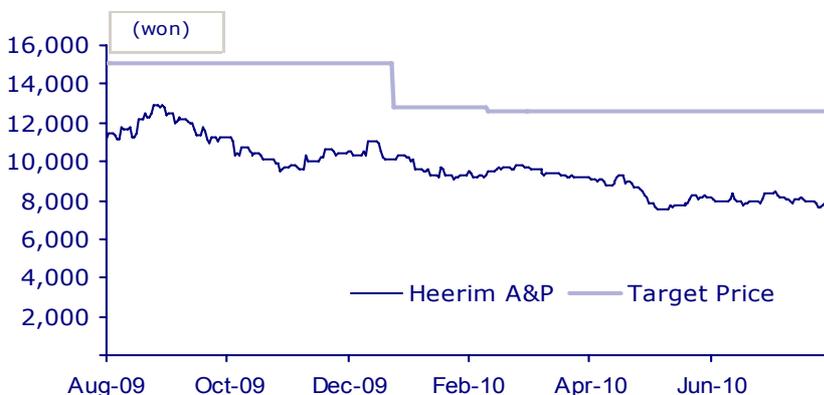
Source: CLSA Asia-Pacific Markets

**Recommendation history - Heerim Architects & Planners 037440 KQ**

Date	Rec level	Closing price	Target
10 August 2010	BUY	7,840.00	12,000.00
26 February 2010	BUY	9,290.00	12,600.00
11 January 2010	BUY	10,100.00	12,800.00
27 August 2009	BUY	11,250.00	15,096.15

Source: CLSA Asia-Pacific Markets

**Target and share price history**



Source: CLSA Asia-Pacific Markets

**Key to CLSA investment rankings:** BUY = Expected to outperform the local market by >10%; O-PF = Expected to outperform the local market by 0-10%; U-PF = Expected to underperform the local market by 0-10%; SELL = Expected to underperform the local market by >10%. Performance is defined as 12-month total return (including dividends).

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Note: In the interests of timeliness, this document has not been edited.

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