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21 June 2010

Korea

Miscellaneous

Reuters 037440.KQ
Bloomberg 037440 KQ

Priced on 17 June 2010

Korea Kospi @ 1,707.9

12M hi/lo 14,135 /7,250 won

12M price target 12,600 won
±% potential +58%
Target set on 16 Jun 10

Shares in issue 12.9m
Free float (est.) 59.6%

Market cap US\$92m

3M average daily volume
.5bn won (US\$.4m)

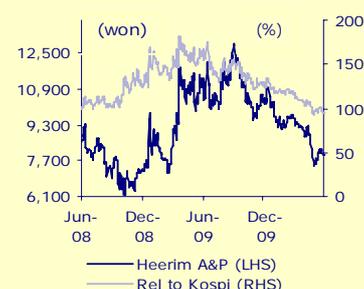
Foreign s'holding 10.4%

Major shareholders

Jeong, Young-Kyoon and related
40.4%

Stock performance (%)

| | 1M | 3M | 12M |
|------------|-------|--------|--------|
| Absolute | 4.7 | (17.9) | (27.3) |
| Relative | 1.3 | (19.1) | (40.8) |
| Abs (US\$) | (0.4) | (23.7) | (24.5) |



Source: Bloomberg

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Growth to pick up

For a company who had over a 20% Cagr for the past 10 years until 2008, 2009 in comparison was a bad year. This was the result of a drop in orders, cancellations and delays due to a weak macro environment both domestically and overseas, which resulted in a flat revenues and a decline in profit. However, new orders have picked up since 2H09 as the macro environment improves, and we believe should start transferring into revenues in 2H10. We expect 50% growth in new orders and 19% in revenue growth for this year. With the share price weakness, valuation is more attractive at 11.7x10 and 7.6x 11. Maintain BUY with 58% upside.

Stronger new orders will be recognized from 2H

Heerim posted a 20% Cagr over the past 10 years until 2008 when 2009 took a turn for the worse with a 27% decline in new orders, slowing revenue recognition along with cancellations due to the weak macro environment. Still, Heerim was able to gain 1% in market share. We believe the worst is over as we have been seeing improving new orders since 2H09. This means that the macro environment is also more favourable with less risk of cancellations in the future. 1Q peaked at W127bn and 2Q flow has also been good so far. These orders will start to contribute from 2H10, and we expect 19% in revenue growth this year. Heerim is well positioned as a top player in the domestic market, and overseas remains a key focus area, especially emerging markets. They are diversifying their country base and will acquire a small US firm sometime in 2H10, to assist in their overseas expansion.

Buying back shares

Treasury shares have increased from 335K at the end of 2008 to 568K at end of 2009, or from 2.5% to 4%. The company will continue to buy back 2bn won in shares until June 2011. This will add another 2% based on yesterday's close. The CEO also personally bought about 28K shares over the past year increasing his stake to 26.3% as of May 2010.

Valuation more attractive

We believe concerns are overdone and the valuation is more attractive at 11.7x 10CL and 7.6x 11CL. Trading around its average, the company deserves a rerating due to its strong earnings growth potential of 48% in 2011CL and 53% in 2012CL. We value the company on 14x 10/11CL PE with a 12,600 won target price. While we have adjusted earnings post full financials update in 1Q, however there has been no change to our target price as the differences was minimal. Maintain BUY with 58% upside.

Financials

| Year to 31 Dec | 08A | 09A | 10CL | 11CL | 12CL |
|-------------------------|---------|--------|--------|---------|---------|
| Revenue (bn won) | 156 | 158 | 189 | 244 | 301 |
| Rev forecast change (%) | - | - | 0.0 | 0.0 | 0.0 |
| Net profit (bn won) | 16 | 9 | 10 | 15 | 23 |
| NP forecast change (%) | - | - | (4.7) | (2.8) | (3.6) |
| EPS (won) | 1100.68 | 607.89 | 684.74 | 1047.16 | 1599.96 |
| EPS growth (% YoY) | 75.6 | (44.8) | 12.6 | 52.9 | 52.8 |
| PE (x) | 7.2 | 13.1 | 11.6 | 7.6 | 5.0 |
| Dividend yield (%) | 4.02 | 2.51 | 3.01 | 3.51 | 3.76 |
| ROE (%) | 30.8 | 15.0 | 15.5 | 18.7 | 22.6 |
| Net debt/equity (%) | (4.4) | 11.8 | 22.0 | (12.1) | (26.9) |

Source: CLSA Asia-Pacific Markets

New orders

1Q peaked at 127bn, helped by 2 large orders from overseas. 2Q flow has also been strong as well and we are confident they can meet our 300bn forecast for this year as they have already achieved 42% of this in 1Q. Stronger orders mean the macro environment is improving and this will reduce risk of cancellations or project being put on hold.

Figure 1

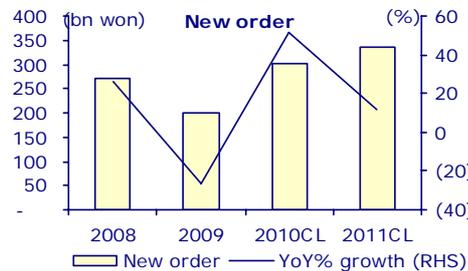
Heerim's major new orders received YTD

| Date | Client | Project | Amount (mn 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 Phillippinne 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 |

Source: CLSA Asia-Pacific Markets

Figure 1

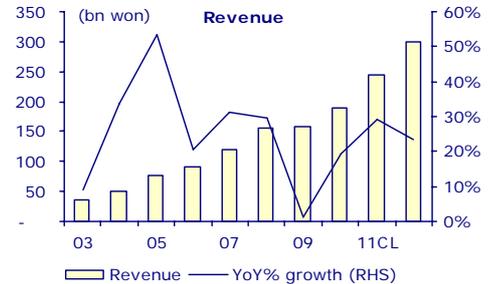
New order trend



Source: CLSA Asia-Pacific Markets

Figure 2

Revenue trend



Source: CLSA Asia-Pacific Markets

Growth to pick up

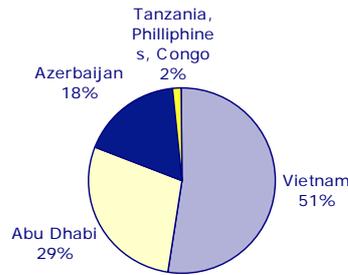
Revenue in 2009 was flat YoY. This was the first year of 0% growth in roughly 10 years due to a 27% decline in new orders, slowed revenue recognition and a few cancellations due to the weak macro environment. Still, Heerim was able to gain 1% market share. We believe the worst is over as we are seeing improving new order flow from 2H09, indicating that the macro environment is more favourable. This order growth will start to contribute to earnings from 2H10, and we expect a total of 19% in revenue growth this year.

Domestic market share gains and market growth: As orders get larger and more complex, larger companies' market share has been increasing. As one of the top 2 companies in Korea, Heerim's market share has increased from an estimated 9.5% in 2008 to 10.4% in 2009. With the government also emphasizing the importance of design, which is very different from in the past when focus was on speed with little or no attention to design. As Korea becomes a more developed country, we believe this market has a lot of potential. Heerim is also increasing CM works as they often receive designs and CM together.

Overseas, entering new markets: This remains the company's key focus. Heerim will be diversifying into other countries, mostly emerging countries. The potential acquisition will help strength growth opportunities in new countries.

Figure 3

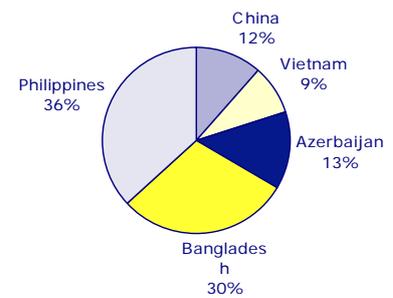
09 new order breakdown



Source: CLSA Asia-Pacific Markets

Figure 4

1Q10 overseas order breakdown



Source: CLSA Asia-Pacific Markets

Share buyback

Treasury shares increased from 335K at the end of 2008 to 568K at the end of 2009, or from 2.5% to 4%. The company will continue to buy back 2bn won in shares until June 2011. This will add another 2% based on yesterday's close. The CEO has personally bought about 28K shares over the past year increasing his stake to 26.3% as of May 2010.

M&A

This will happen within 3Q with acquisition of a small US company that has exposure to Central America. Deal size will be less than 10bn. Overseas orders will continue to remain the key growth driver as Heerim will continues to focus on emerging markets.

Valuation

We have cut our earnings by 30% for 2009 and 37% for 2010CL compared with our initiation in August 2009. The share price and foreign ownership have been down by about 31% and 5% respectively since its peak in September 2009 to 10%.

We believe concerns are overdone and the valuation in more attractive at 11.7x 2010CL and 7.6x 2011CL. Trading around its average, the company deserves a rerating due to strong earnings growth of 9% in 10CL, 48% in 2011CL and 53% in 2012CL.

We have adjusted earnings post 1Q full financials update but this has been minimal, so there has been no change in our TP of 12,600 won based on the 14x 2010/2011CL multipule. BUY with 58% upside.

Figure 6

12 month forward PE ratio



Figure 7

12 month forward PB ratio



Source: CLSA Asia-Pacific Markets

Figure 8

Share price vs. foreign ownership %



Source: CLSA Asia-Pacific Markets

Summary financials

| Year to 31 December | 2008A | 2009A | 2010CL | 2011CL | 2012CL |
|--|------------|-------------|------------|------------|------------|
| Summary P&L forecast (bn won) | | | | | |
| Revenue | 156 | 158 | 189 | 244 | 301 |
| Op Ebitda | 18 | 16 | 19 | 25 | 36 |
| Op Ebit | 16 | 13 | 16 | 22 | 32 |
| Interest income | 0 | 0 | 0 | 0 | 0 |
| Interest expense | 0 | (1) | (1) | 0 | 0 |
| Other items | 4 | (1) | (2) | (2) | (2) |
| Profit before tax | 20 | 12 | 13 | 20 | 30 |
| Taxation | (5) | (3) | (4) | (5) | (7) |
| Minorities/Pref divs | 0 | 0 | 0 | 0 | 0 |
| Net profit | 16 | 9 | 10 | 15 | 23 |
| Summary cashflow forecast (bn won) | | | | | |
| Operating profit | 16 | 13 | 16 | 22 | 32 |
| Operating adjustments | 0 | 0 | 0 | 0 | 0 |
| Depreciation/amortisation | 2 | 3 | 3 | 4 | 4 |
| Working capital changes | (27) | (15) | (21) | (6) | (10) |
| Net interest/taxes/other | 4 | 6 | 3 | 4 | 0 |
| Net operating cashflow | (4) | 7 | 1 | 23 | 27 |
| Capital expenditure | (3) | (3) | (2) | (3) | (3) |
| Free cashflow | (7) | 4 | (1) | 21 | 24 |
| Acq/inv/disposals | 7 | (6) | (3) | (6) | 0 |
| Int, invt & associate div | (1) | (1) | (1) | 0 | 0 |
| Net investing cashflow | 3 | (10) | (6) | (8) | (2) |
| Increase in loans | 4 | 15 | 0 | 0 | 0 |
| Dividends | (3) | (4) | (3) | (4) | (6) |
| Net equity raised/other | (3) | (2) | 0 | 0 | 0 |
| Net financing cashflow | (2) | 9 | (3) | (4) | (6) |
| Incr/(decr) in net cash | (4) | 5 | (8) | 11 | 18 |
| Exch rate movements | 0 | 0 | 0 | 0 | 0 |
| Opening cash | 6 | 2 | 8 | 0 | 11 |
| Closing cash | 2 | 8 | 0 | 11 | 29 |
| Summary balance sheet forecast (bn won) | | | | | |
| Cash & equivalents | 2 | 8 | 0 | 11 | 29 |
| Debtors | 44 | 60 | 85 | 100 | 124 |
| Inventories | 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 | 7 | 7 | 7 | 7 | 7 |
| Total assets | 75 | 102 | 119 | 152 | 192 |
| Short-term debt | 0 | 0 | 0 | 0 | 0 |
| Creditors | 0 | 0 | 0 | 0 | 0 |
| Other current liabs | 16 | 25 | 33 | 42 | 53 |
| Long-term debt/CBs | 0 | 15 | 15 | 0 | 0 |
| Provisions/other LT liabs | 2 | 3 | 4 | 17 | 29 |
| Minorities/other equity | 0 | 0 | 0 | 0 | 0 |
| Shareholder funds | 56 | 60 | 67 | 93 | 110 |
| Total liabs & equity | 75 | 102 | 119 | 152 | 192 |
| Ratio analysis | | | | | |
| Revenue growth (% YoY) | 29.7 | 1.3 | 19.4 | 29.3 | 23.4 |
| Ebitda growth (% YoY) | 27.0 | (11.4) | 18.6 | 32.8 | 43.5 |
| Ebitda margin (%) | 11.7 | 10.2 | 10.1 | 10.4 | 12.1 |
| Net profit margin (%) | 10.1 | 5.5 | 5.2 | 6.2 | 7.6 |
| Dividend payout (%) | 29.1 | 32.9 | 35.1 | 26.7 | 18.8 |
| Effective tax rate (%) | 22.5 | 27.2 | 27.2 | 24.2 | 24.2 |
| Ebitda/net int exp (x) | 0.0 | 60.9 | 20.1 | 0.0 | 0.0 |
| Net debt/equity (%) | (4.4) | 11.8 | 22.0 | (12.1) | (26.9) |
| ROE (%) | 30.8 | 15.0 | 15.5 | 18.7 | 22.6 |
| ROIC (%) | 26.9 | 16.3 | 16.3 | 20.2 | 27.3 |
| EVA™/IC (%) | 16.3 | 5.7 | 5.7 | 9.6 | 16.7 |

Source: CLSA Asia-Pacific Markets

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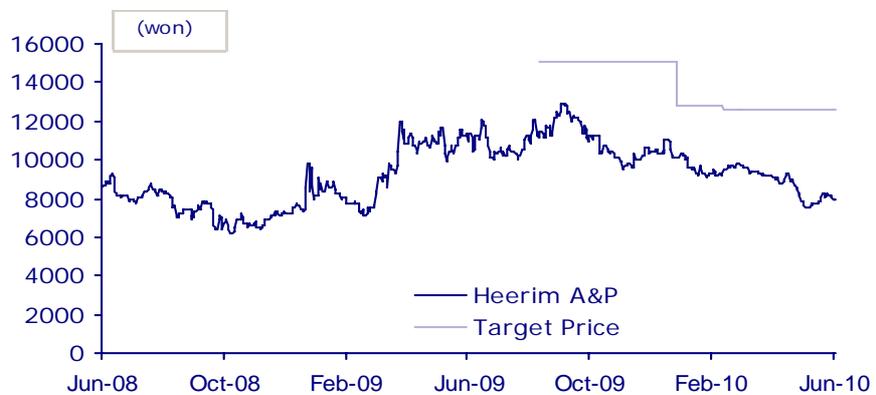
Recommendation history - Heerim Architects & Planners 037440 KQ

| Date | Rec level | Closing price | Target |
|------------------|-----------|---------------|-----------|
| 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

Figure 3

Target-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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