

Initiation

Heerim Architects & Planners

(037440.KS)

Korea / Engineering & Construction

Sep 2, 2008

BUY (Initiate)

Rating within Industry: **Overweight**
Earnings Quality Score: **Medium**
Price Volatility: **Low**

Design the World

Initiation coverage with BUY rating and TP of 11,600

We initiate coverage on Heerim Architects & Planners with a **BUY** rating and TP of W11,600. Our TP is equivalent to 9.7x FY08 forecast EPS. The TP offers a 51% upside from the current price (as of September 1). We believe the implied beta of 1.0x from the target P/E of 9.7x is conservative as the company's historically highest beta was only 0.51x.

Growth momentum based on competitiveness in receiving orders

We expect Heerim to expand its sales by 27.6% and OP by 31.1% over the next three years, led by an overseas division with strong competitiveness. Of note, the company is increasingly being awarded design competition contracts, evincing its competitiveness and increasing its operating margin. Also, in terms of revenue per architect, design competition projects are rapidly rising, evidencing improved productivity per person and the trend of recent larger scale projects.

Heerim as a global design company

The most important growth engine for Heerim is its overseas business. Heerim has been receiving new orders from emerging economies such as Vietnam, Central Asia, and the Middle East. However, we believe, for more stable growth and higher margins, it is necessary to enter into developed markets. The company is actively soliciting business and if the company succeeds in entering these markets, it would be a big step to transforming into a global design company.

Forecast Earnings & Valuation

Fiscal year	ending Dec.	2006	2007	2008E	2009E	2010E
Sales/Revenue	(W bn)	91.5	120.1	170.7	214.4	249.8
OP	(W bn)	4.7	12.4	19.1	25.2	28.0
EBITDA	(W bn)	6.1	14.3	21.5	27.7	30.5
Pre-tax profit	(W bn)	4.2	12.9	20.7	26.6	29.6
NP	(W bn)	3.5	9.0	15.3	19.3	21.5
EPS	(W)	268	697	1,186	1,495	1,666
YoY	(%)	(28.2)	160.1	70.2	26.1	11.4
P/E	(x)	11.8	12.5	7.0	5.5	5.0
P/B	(x)	1.2	2.4	2.0	1.5	1.2
EV/EBITDA	(x)	6.0	7.1	4.2	2.9	2.2
ROE	(%)	10.8	22.7	29.4	29.4	26.4

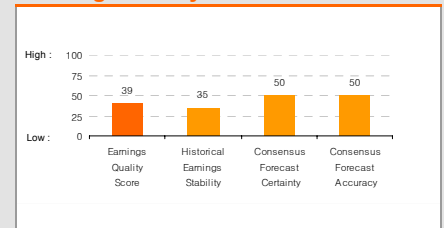
Target Price & Expected Return

Target Price (6M)	W11,600
Consensus Target Price	W15,500
Current Price (Aug.29)	W8,250
Expected DPS (08E)	W300
Expected Price Return (6M)	40.6%
Expected Dividend Yield (12M)	3.6%

Fundamental Data

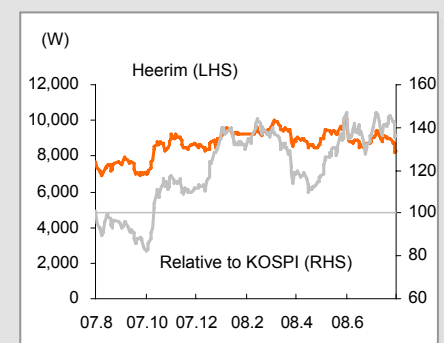
Expected EPS (08E/09E)	W1,186 / W1,495
Consensus EPS (08E/09E)	W1,185 / W1,467
Est. 3-Yr EPS Growth (CAGR)	33.7%
Hist. 5-Yr EPS Growth (CAGR)	45.7%
Net Debt / Equity (08E)	(28.3%)

Earnings Quality Score



Trading Data

Market Cap. (W bn / US\$ mn)	106 / 98
Shares Outstanding	13mn
Free Float	57.1%
Adj. Beta	0.7
Price Return Volatility	59.0%
52-Week Price High/Low	W10,100 - 6,900
Daily Average Volume (3M)	45,498
Daily Average Turnover (3M)	W408mn
Foreign Ownership	7.8%



Initiate coverage with BUY rating and TP of 11,600

Initiate coverage with BUY rating and TP of W11,600

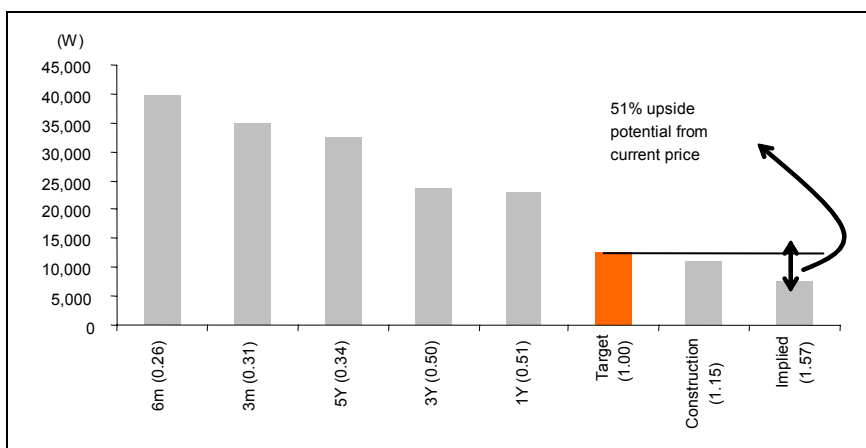
We initiate coverage on Heerim Architects & Planners with a **BUY** rating and TP of W11,600. Our TP is equivalent to 9.7x FY08 forecast EPS. The TP offers a 51% upside from the current price (as of September 1). We believe the implied beta of 1.0x from the target P/E of 9.7x is conservative as the company's historically highest beta was only 0.51x. Although this figure is lower than the last 10-year average beta of 1.12x of the construction sector, we believe the target P/E is reasonable given that the company is immune to recent construction industry issues such as: 1) unsold homes risk; and 2) lowering AR turnover (Heerim has the highest level amongst domestic players).

<Figure 1> Multiples with TP of W11,600

(x)	T-P/E	T-P/B	T-EV/EBITDA
2008E	9.7	2.6	6.4
2009E	7.7	2.1	4.7
2010E	7.0	1.7	3.9

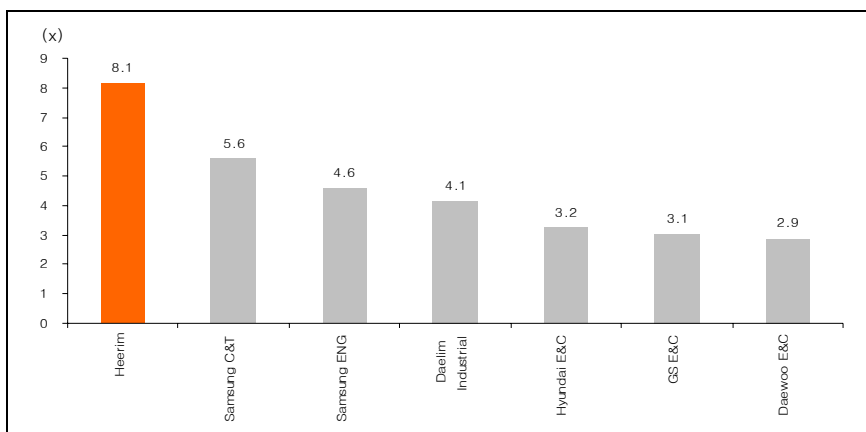
Source: Heerim, Mirae Asset Research estimates
 Note: Based on Sep 1, 2008

<Figure 2> 51% Upside Potential Despite Conservative Approach



Source: Mpustat, Mirae Asset Research
 Note: Based on Sep 1, 2008

<Figure 3> Highest Account Receivable Turnover Ratio of Domestic Players



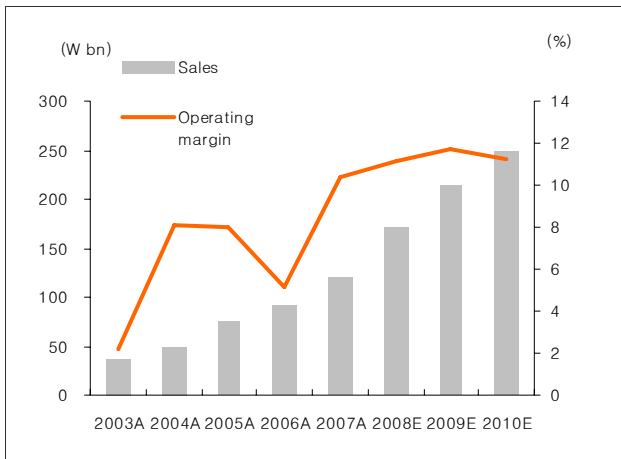
Source: Mpustat, Mirae Asset Research

Growth momentum based on strong order receipt competitiveness

Expect CAGR of 31.1% over next 3 years backed by the competitiveness in design competition projects

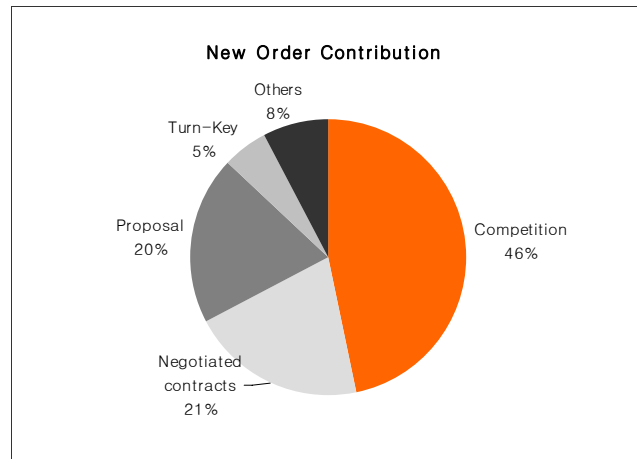
We expect Heerim to expand its sales by 27.6% and OP by 31.1% over the next three years, led by an overseas division with strong competitiveness despite the slowdown forecast in the domestic division. Of note, the company is increasingly being awarded design competition contracts, evincing its competitiveness and increasing its operating margin. Also, in terms of revenue per architect, design competition projects are rapidly rising, evidencing improved productivity per person and the trend of recent larger scale projects.

<Figure 4> Increasing Sales and Stable Operating Margin

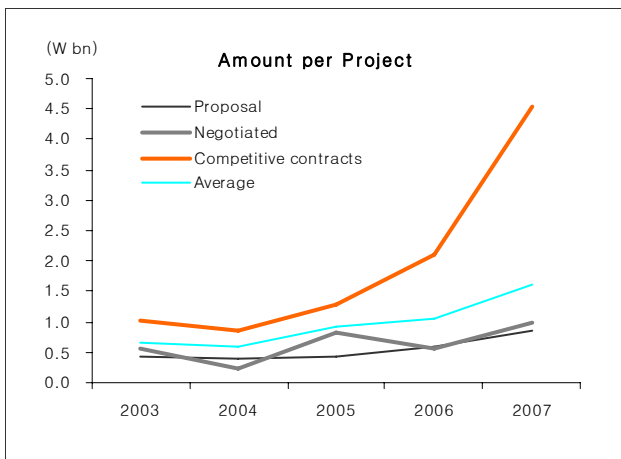


Source: Heerim, Mirae Asset Research

<Figure 5> New Order Contribution

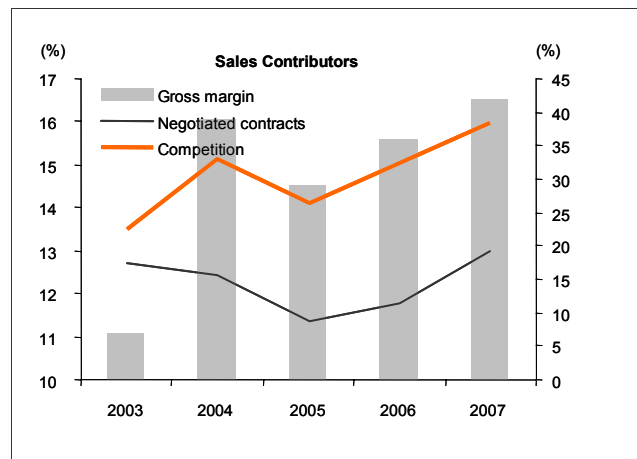


<Figure 6> New Order Amount per Project



Source: Heerim, Mirae Asset Research

<Figure 7> Gross Margin and Awarded Contracts

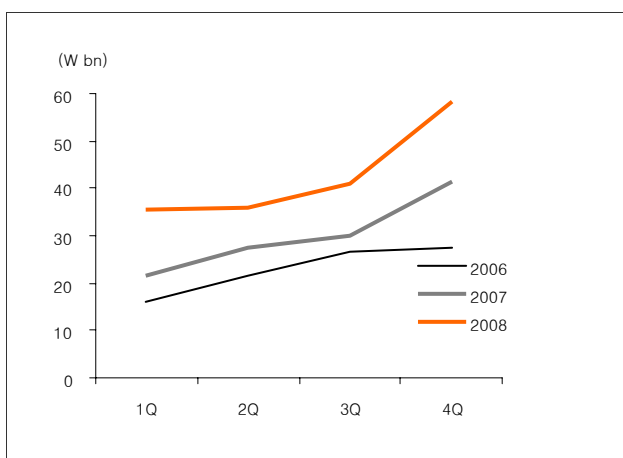


Stabilized quarterly profitability

Stabilized profitability

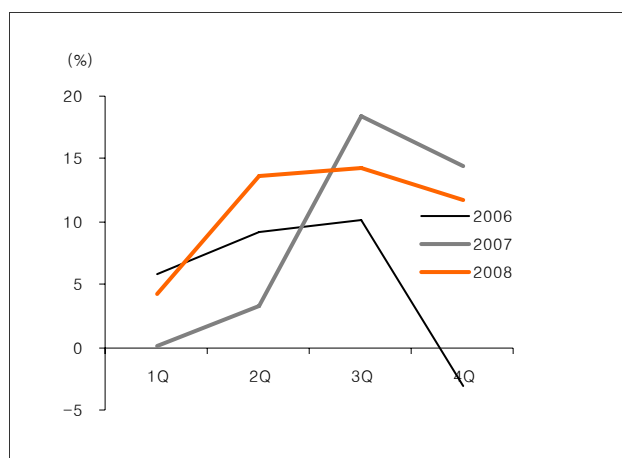
The company's revenue has been growing rapidly since 2008, backed to a large extent by outstanding growth in its overseas division and a stabilizing operating margin has also been stabilized on increases in sales. We forecast sales to grow 35.8% and OP to grow 4.9% in 3Q08, even though operating margin should decline 4.2%p due as profitability has yet to become stable.

<Figure 8> Quarterly Sales on the Rise



Source: Heerim, Mirae Asset Research

<Figure 9> Stabilized OP Margin



<Figure 10> 3Q08 Preview

(W bn, %)	3Q 07	2Q 08	3Q 08E	QoQ	YoY
Sales	30.1	35.8	40.8	14.0	35.8
GP	8.2	7.4	8.7	16.7	6.1
OP	5.6	4.9	5.8	18.8	4.9
Pretax profit	5.6	5.4	6.1	13.5	10.1
NP	5.6	3.7	4.4	21.1	(20.2)
GP margin	27.2	20.8	21.3	0.5%p	(5.9%)p
OP margin	18.5	13.7	14.3	0.6%p	(4.2%)p
Pretax profit margin	18.5	15.1	15.0	-0.1%p	(3.5%)p
NP margin	18.5	10.2	10.9	0.6%p	(7.6%)p

Source: Heerim, Mirae Asset Research estimates

<Figure 11> Quarterly Estimates

(W bn, %)	1Q07	2Q07	3Q07	4Q07	1Q08	2Q08	3Q08	4Q08	1Q09	2Q09	3Q09	4Q09
Sales	21.6	27.3	30.1	41.2	35.6	35.8	40.8	57.9	42.8	44.9	51.3	74.9
GP	1.2	3.2	8.2	9.9	4.3	7.4	8.7	10.1	5.1	7.2	9.8	16.1
OP	0.0	0.9	5.6	5.9	1.5	4.9	5.8	6.7	2.0	4.4	6.7	12.0
Pretax profit	0.1	0.9	5.6	6.3	2.0	5.4	6.1	7.1	2.3	4.7	7.1	12.4
NP	0.1	0.6	5.6	2.7	2.0	3.7	4.4	5.1	1.7	3.4	5.1	9.0
GP margin	5.6	11.6	27.2	24.0	12.1	20.8	21.3	17.5	12.0	16.0	19.0	21.5
OP margin	0.1	3.3	18.5	14.4	4.2	13.7	14.3	11.6	4.7	9.7	13.1	16.1
Pretax margin	0.5	3.5	18.5	15.2	5.6	15.1	15.0	12.3	5.5	10.6	13.8	16.6
NP margin	0.5	2.2	18.5	6.6	5.6	10.2	10.9	8.9	4.0	7.7	10.0	12.0

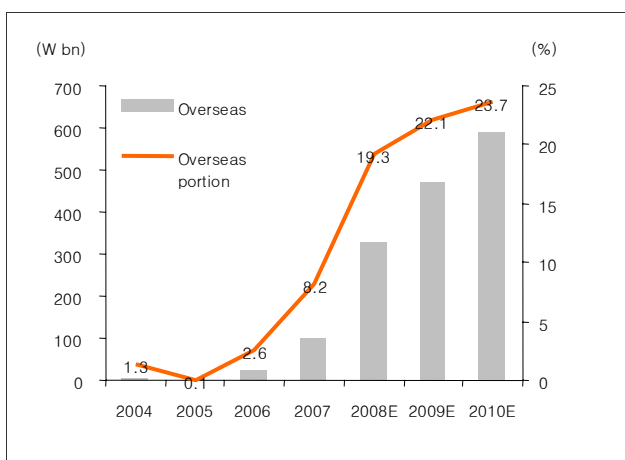
Source: Heerim, Mirae Asset Research estimates

Dream of Heerim as a global design company

Dream to become a global design company through expansion of overseas division

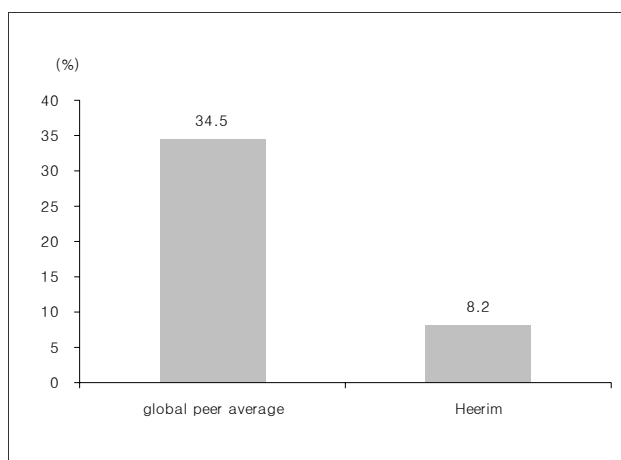
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<Figure 12> Increasing Overseas Sales



Source: Heerim, Mirae Asset Research

<Figure 13> Overseas Division Expected to Additional Growth



Ownership structure and risk factors

Company growth can be affected by the slowdown in the global economy

CEO Jeong, Young-Kyoon and three others hold a 41.5% stake in Heerim. Corporate shareholders including NPS (National Pension Service) have a 12.5% stake and the proportion of treasury stock is 2.5%. Free float shares account for approximately 43% of its shares, but the company's 20-day average trading volume stands at only 200,000 shares. Such a thinly traded stock is worrisome for investors. High receipts competitiveness, top-tier stability of its overseas clients, and the growth potential from entering developed markets should support relatively high growth and low risk compared to other domestic construction companies. There remains the risk that the company's growth rate can slow if the global economy is remains sluggish for an extended period.

Summary Financial Statements

Balance Sheet

(W bn)	2006	2007	2008E	2009E	2010E
Current assets	17.1	35.1	50.4	69.7	88.7
Cash and equivalents	3.3	9.1	15.4	26.1	38.1
Receivables	10.0	19.5	27.7	34.8	40.6
Inventories	0.0	0.0	0.0	0.0	0.0
Fixed assets	20.7	22.1	22.6	22.5	22.5
Investment assets	7.2	8.1	8.1	8.1	8.1
Tangible assets	8.3	9.1	10.0	10.4	10.8
Intangible assets	5.1	4.9	4.4	4.0	3.6
Total assets	37.8	57.2	72.9	92.2	111.2
Current liabilities	3.7	9.3	13.2	16.5	19.3
Payables	0.0	0.0	0.0	0.0	0.0
ST debt	0.0	0.0	0.0	0.0	0.0
Cp of LT debt	0.0	0.0	0.0	0.0	0.0
Fixed liabilities	1.0	1.8	1.8	1.8	1.8
Corp.Bond	0.0	0.0	0.0	0.0	0.0
LT debt	0.0	0.0	0.0	0.0	0.0
Total liabilities	4.6	11.1	15.0	18.4	21.1
Paid-in capital	5.5	6.5	6.5	6.5	6.5
Capital surplus	3.0	6.4	6.4	6.4	6.4
Retained earnings	25.9	33.2	45.3	60.8	77.1
Capital adjustments	(1.2)	0.0	(0.2)	(0.2)	(0.2)
Shareholders' equity	33.1	46.1	57.9	73.4	89.7
Total debt	0.0	0.0	0.0	0.0	0.0
Net debt	(4.3)	(10.1)	(16.4)	(27.2)	(39.1)

Income Statement

(W bn, %)	2006	2007	2008E	2009E	2010E
Sales	221.2	256.4	270.5	293.4	325.9
Change	3.7	15.9	5.5	8.5	11.1
Cost of sales	101.2	114.3	123.4	126.6	136.8
Gross profit	120.0	142.1	147.0	166.7	189.1
Change	4.6	18.4	3.5	13.4	13.4
Gross margin	54.2	55.4	54.4	56.8	58.0
SG&A	111.2	116.5	118.3	134.6	152.2
Op income	8.8	25.6	28.7	32.1	37.0
Change	2,020.7	191.1	12.0	11.9	15.1
Non-opr income	0.4	(2.5)	3.4	4.0	3.8
Net financial expenses	1.7	0.3	(1.2)	(2.5)	(2.4)
FC translation gain	(0.7)	(0.1)	0.8	0.7	0.7
Associate gain	0.1	0.2	0.4	0.4	0.4
Others	2.7	(2.4)	1.0	0.4	0.2
Extraordinary income	9.2	23.1	32.1	36.2	40.7
Pre-tax Income	3.3	4.6	10.6	12.4	14.0
Tax	5.9	18.5	21.5	23.7	26.7
Net income	358	1,119	1,298	1,431	1,613
EPS	TB	212.6	16.0	10.2	12.7
Change	31.5	47.7	50.5	54.2	58.9
EBITDA	32.5	51.3	5.8	7.4	8.6
Change	221.2	256.4	270.5	293.4	325.9

Cash Flow Statement

(W bn)	2006	2007	2008E	2009E	2010E
Opr. cash flow	7.3	7.1	14.3	17.0	19.7
Net income	3.5	9.0	15.3	19.3	21.5
Depreciation	1.2	1.7	1.9	2.1	2.1
Depr of intangible	0.1	0.2	0.5	0.4	0.4
FC translation loss (gain)	0.0	0.0	(0.1)	0.0	(0.1)
Associate loss (gain)	0.3	0.0	0.0	0.0	0.0
Chg in working capital	(1.5)	(9.6)	(8.2)	(7.1)	(5.8)
Chg in receivables	(1.5)	(9.6)	(8.2)	(7.1)	(5.8)
Chg in inventories	0.0	0.0	0.0	0.0	0.0
Chg in payables	0.0	0.0	0.0	0.0	0.0
Others	3.7	5.8	4.9	2.3	1.6
Invest. Cash flow	(3.2)	(8.3)	(4.8)	(2.4)	(2.6)
ST financial instrument disposal (purchase)	1.1	(2.8)	0.0	0.0	0.0
Securities disposal (purchase)	0.0	0.0	0.0	0.0	0.0
Tangible asset purchase	(1.8)	(2.5)	2.8	2.4	(2.5)
Tangible asset disposal	0.0	0.0	0.0	0.0	0.0
Intangible asset disposal (purchase)	0.0	0.0	0.0	0.0	0.0
Investment asset disposal (purchase)	(0.2)	0.1	0.0	0.0	0.0
Others	(2.3)	(3.1)	(7.6)	(4.8)	(0.1)
Financ. Cash flow	(1.7)	4.2	(3.2)	(3.9)	(5.2)
Debt raised (repaid)	0.0	0.0	0.0	0.0	0.0
Capital raised (repaid)	0.0	5.7	0.0	0.0	0.0
Dividends	(1.5)	(1.7)	(3.2)	(3.9)	(5.2)
Others	(0.2)	0.2	0.0	0.0	0.0
Net cash flow	2.4	3.0	6.3	10.7	12.0
Beginning cash	0.9	3.3	6.3	12.6	23.3
Ending cash	3.3	6.3	12.6	23.3	35.3
FCF	4.1	(1.2)	9.5	14.6	17.1

Source: Company data, Mirae Asset Research estimates

Key Investment Index

(Won, %, x)	2006	2007	2008E	2009E	2010E
Per share data					
EPS	268	697	1,186	1,495	1,666
BPS	2,176	3,191	4,145	5,377	6,671
EBITDA per share	476	1,112	1,666	2,146	2,363
DPS	400	500	300	400	500
P/E	11.8	12.5	7.0	5.5	5.0
P/B	1.2	2.4	2.0	1.5	1.2
EV/EBITDA	6.0	7.1	4.2	2.9	2.2
Dividend Yield	5.3	2.9	3.6	4.8	6.1
Profitability %					
Gross margin	15.6	18.7	18.0	17.8	17.7
Operating margin	5.1	10.3	11.2	11.8	11.2
EBITDA margin	6.7	11.9	12.6	12.9	12.2
Net income margin	3.8	7.5	9.0	9.0	8.6
ROE	10.8	22.7	29.4	29.4	26.4
ROIC	14.0	24.2	29.8	29.8	26.0
Stability %					
Debt ratio	13.9	24.1	25.9	25.1	23.5
Net debt ratio	Net Cash	Net Cash	Net Cash	Net Cash	Net Cash
Current ratio	462.2	377.4	381.8	422.4	459.6
Activity ratio (Turnover)	(20.0)	(58.2)	(38.2)	(84.0)	(93.3)
Total Assets (x)					
Receivables (x)	2.5	2.5	2.6	2.6	2.5
Inventories (x)	9.1	8.1	7.2	6.9	6.6
Payables (x)	0.0	0.0	0.0	0.0	0.0
Net working capital (x)	0.0	0.0	0.0	0.0	0.0

Source: Company data, Mirae Asset Research estimates

Recommendation

By item (six months)

Buy: A target price of over + 20% of the current price,
 Hold: A target price of - 10% to +10% of the current price
 Reduce: A target price of -20% or less than the current price
 * Note: Correction of -10% to +10% is possible based on the investment recommendations by industry.

By industry

Attractive: over +10% of the current industry index
 Neutral: -10% to +10% of the current industry index
 Cautious: -10% or less than the current industry index
 Terminology of Investment recommendation by industry has changed since August 3, 2005 as follows: Overweight → Attractive / Underweight → Cautious.

Earnings Quality Score

Earnings Quality Score = 0.70*(Historical Earnings Stability) + 0.15*(Consensus Forecast Certainty) + 0.15*(Consensus Forecast Accuracy)

1. Historical Earnings Stability

- The variability of the net profit growth rate (YOY) over the last 20 quarters was translated into percentage terms.
- Earnings growth variability was calculated based on MAD (Median Absolute Deviation), rather than SD (Standard Deviation) in order to minimize distortion from outliers.
- The lower the earnings growth variability, the higher this indicator.

2. Consensus Forecast Certainty

- The gap between analysts' views on 12-month forward EPS was translated into percentage terms.
- The gap is calculated by dividing the SD of 12-month forward EPS with the average value.
- The narrower the gap is, the higher the indicator's reliability.

3. Consensus Forecast Accuracy

- The median value of absolute EPS surprise over the last 3-year was translated into percentage terms.
- EPS surprise was calculated based on 'the actual figure at the end of the year / the consensus estimate at the beginning of the year - 1'.
- The lower the absolute EPS surprise, the higher this indicator.

* Reference

- 1) Consensus Forecast Certainty and Consensus Forecast Accuracy were applied only to companies with more than 5 years of EPS estimates.
- 2) We gave the average score of 50 to cases in which the aforementioned indicators could not be produced.

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Item	Analyst	Type	Securities Held by the Analyst			Holdings of Shares over 1%	Participation in the Issuance of Securities	Involvement with the Affiliates	Treasury Stock Acquired
			Number of Shares	Purchasing Price	Purchasing Date				
N/A									

