

# Korean Corporates: **Recovery In Credit Quality And ESG Initiatives**

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*This report does not constitute a rating action*

# Key Takeaways

- Credit quality has recovered and will remain steady for Korean corporates, as reflected in more positive rating actions this year compared with 2020.
- Demand for various export products including semiconductors and consumer durables will stay strong, even amid continuing COVID-19.
- Despite supply-chain disruptions, profitability remains robust for Korean automakers.
- ESG factors are becoming more important to Korean companies' strategies and investment decisions.
- We expect balanced and stable 2022 credit outlook for Korean corporates.

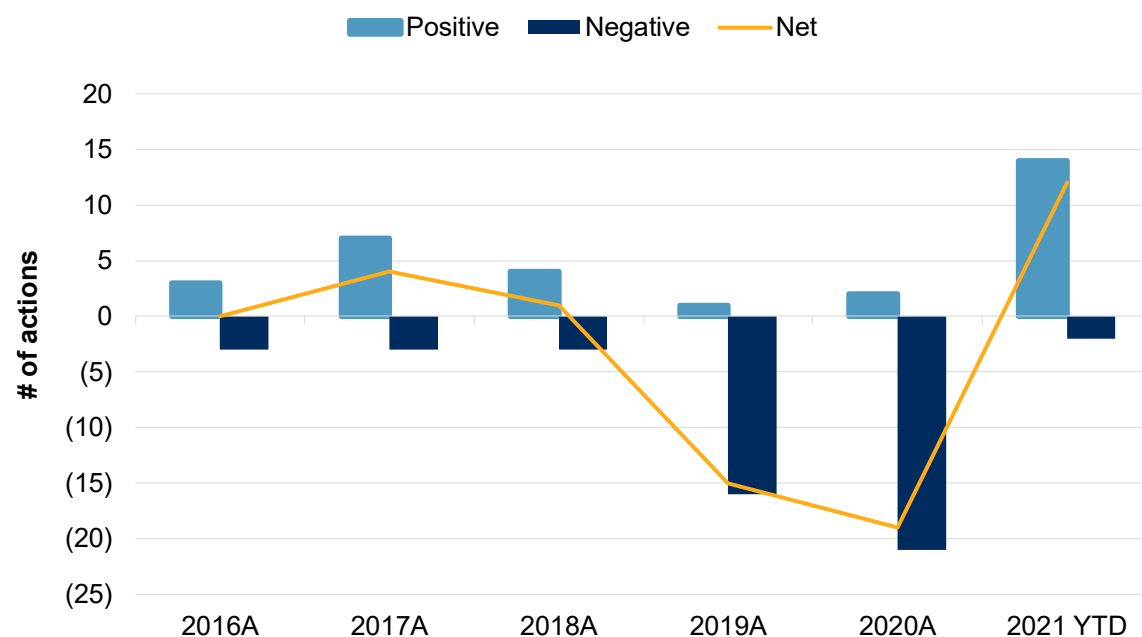
# I. Credit Quality Trend: Recovery Amid COVID-19



# Korean Corporates' Credit Quality Notably Recovered In 2021

- Positive rating actions outweigh negative rating actions in 2021 vs. 2019 and 2020.
- Improving profitability drives upside actions on Hyundai Motor Group, SK Hynix, LG Electronics and POSCO in 2021.

## Positive Rating Action Trend\*



## Major Rating Actions On Korean Corporates In 2021\*

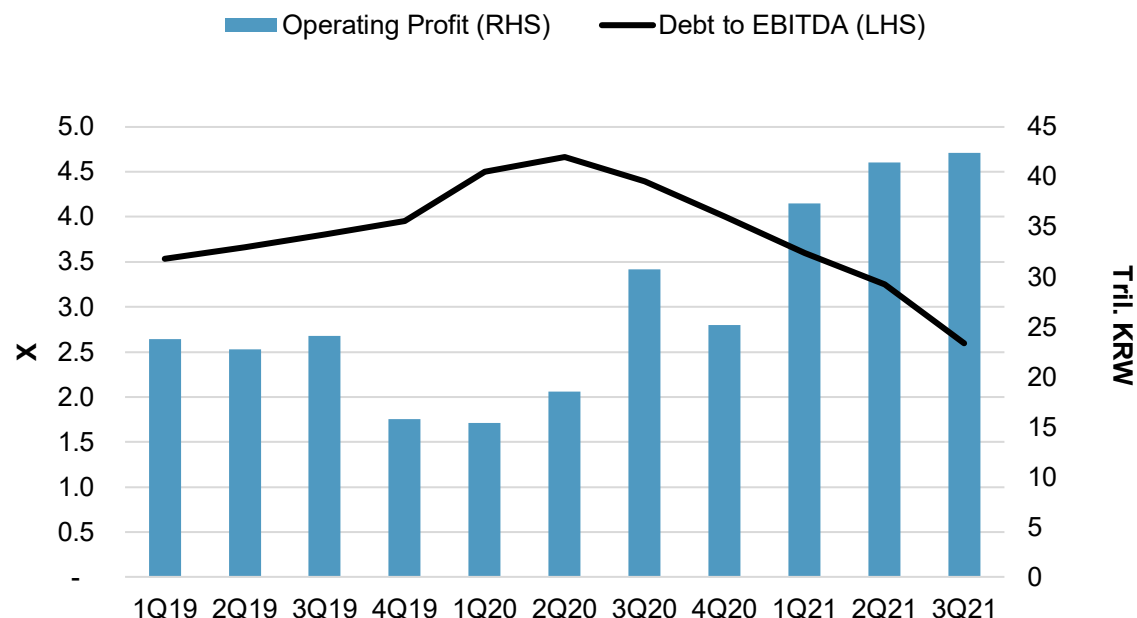
Company	Date	To	From
S-Oil	Mar-2021	BBB/Stable	BBB/Negative
SK Hynix	Mar-2021	BBB-/Positive	BBB-/Stable
SK Telecom	Mar-2021	A-/Stable	A-/Negative
LG Electronics	Apr-2021	BBB/Positive	BBB/Stable
Magnachip Semiconductor	Apr-2021	B+/Stable	B/Positive
POSCO	Jun-2021	BBB+/Positive	BBB+/Stable
Hanjin International	Aug-2021	B-/Negative	CCC+/Negative
Hyundai Motor Group <sup>§</sup>	Sep-2021	BBB+/Stable	BBB+/Negative
E-Mart	Nov-2021	BBB-/Negative	BBB-/Watch Neg

\*As of Dec 1, 2021. <sup>§</sup>Hyundai Motor Group includes Hyundai Motor, Kia Corp., Hyundai Mobis, Hyundai Glovis and Hyundai Steel. A--Actual. YTD—Year To Date. Source: S&P Global Ratings.

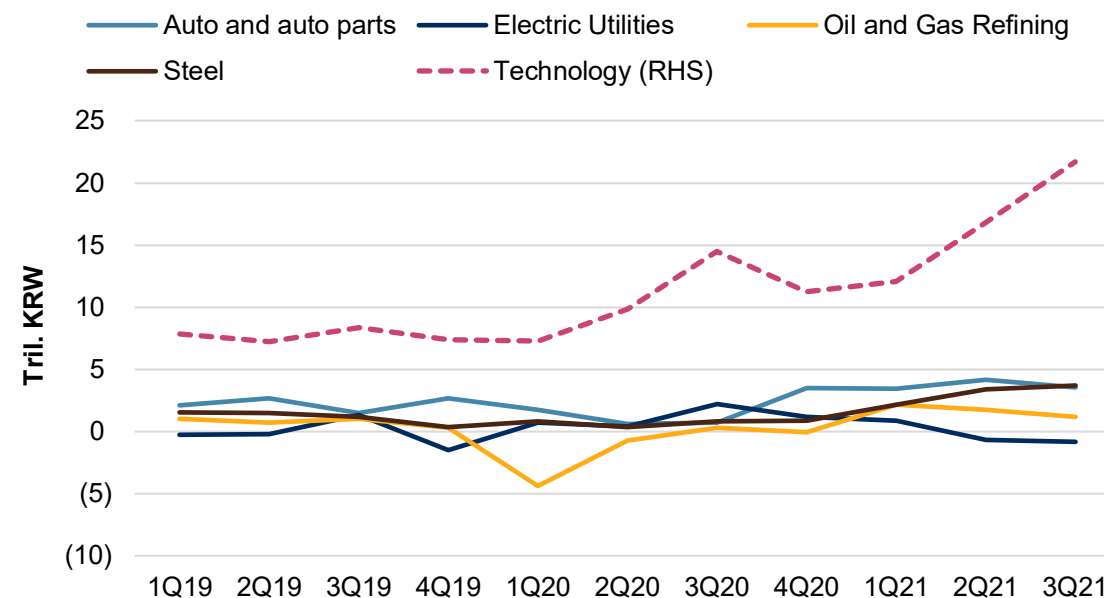
# Top 200 Korean Corporates' Financial Metrics Are Improving

- Debt/EBITDA of top 200 Korean companies further recovered in 3Q21.
- Stronger profitability is behind the improvement in financial metrics.
- Rapid demand recovery for various products (e.g. semiconductor, consumer electronics) is driving strong profitability.

## Top 200 Corporates Quarterly Debt to EBITDA\* Trend



## Top 200 Corporates' Quarterly OP By Sector



\*Top 200 corporates by asset size (excluding financial institutions and unlisted government-related entities), excluding Samsung Electronics. Annualized EBITDA (sum of last 4 quarters' EBITDA). §Top 200 corporates by asset size (excluding financial institutions and unlisted government-related entities). OP--Operating profit. Tril--Trillion. KRW--Korean won. RHS--Right hand scale. LHS--Left hand scale. Source: Capital IQ, S&P Global Ratings.

## **II. Technology:**

**Solid Performance On Strong Demand**

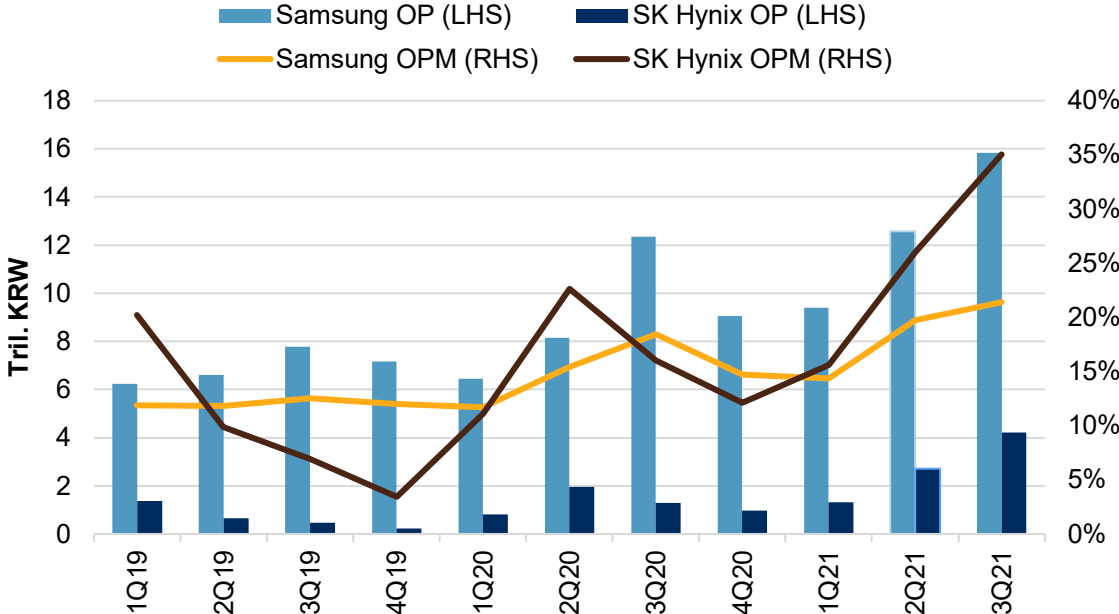
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# Semiconductor Companies Benefit From COVID-19

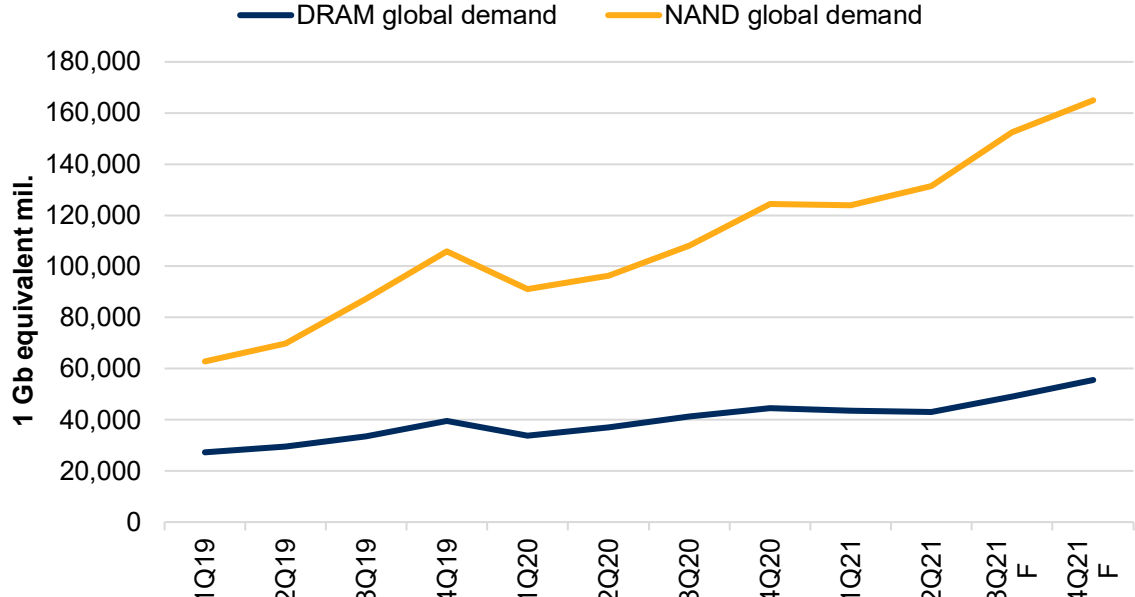
- Remote access and data processing/storage are spurring strong memory-chip demand.
- Operating profit grew 40% and 103% for Samsung and Hynix in 9M21, respectively, after 30%/85% YoY growth in 2020.
- S&PGR revised outlook on SK Hynix to positive from stable in March 2021.

## Profit, Margins Look Strong For Samsung, SK Hynix



Note: YoY—Year on year. OP—operating profit. OPM—operating profit margin. Tril.—Trillion. KRW—Korean won. LHS—Left hand scale. RHS—Right hand scale. Source: Company data, Omdia, S&P Global Ratings.

## Semiconductor Global Demand Is Solid

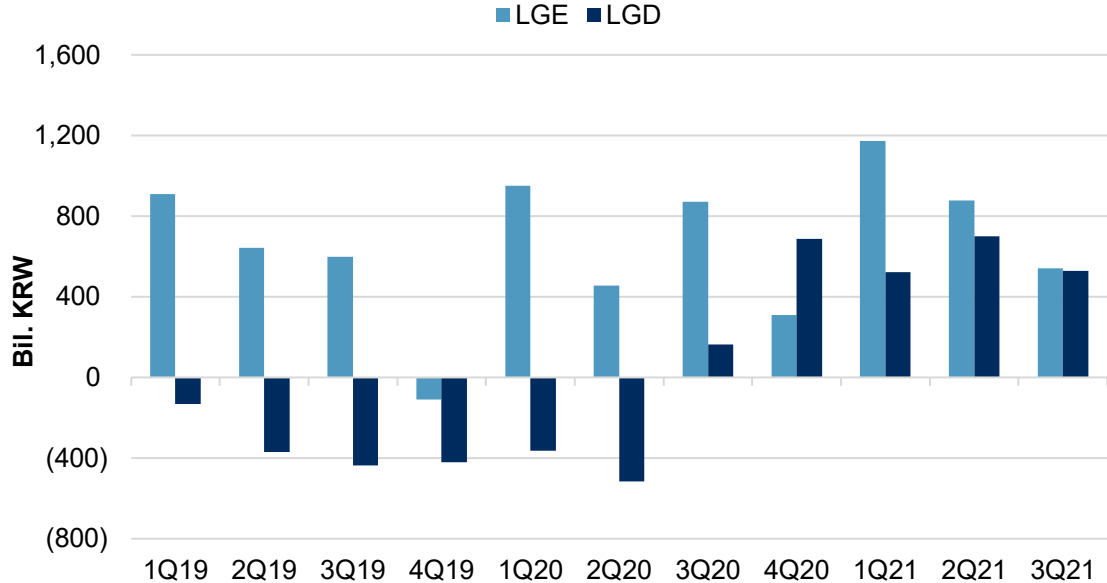


Gb—Gigabyte. Mil.—Million. Source: Company data, Omdia, S&P Global Ratings.

# LG Electronics Shows Strong Profitability Amid COVID-19

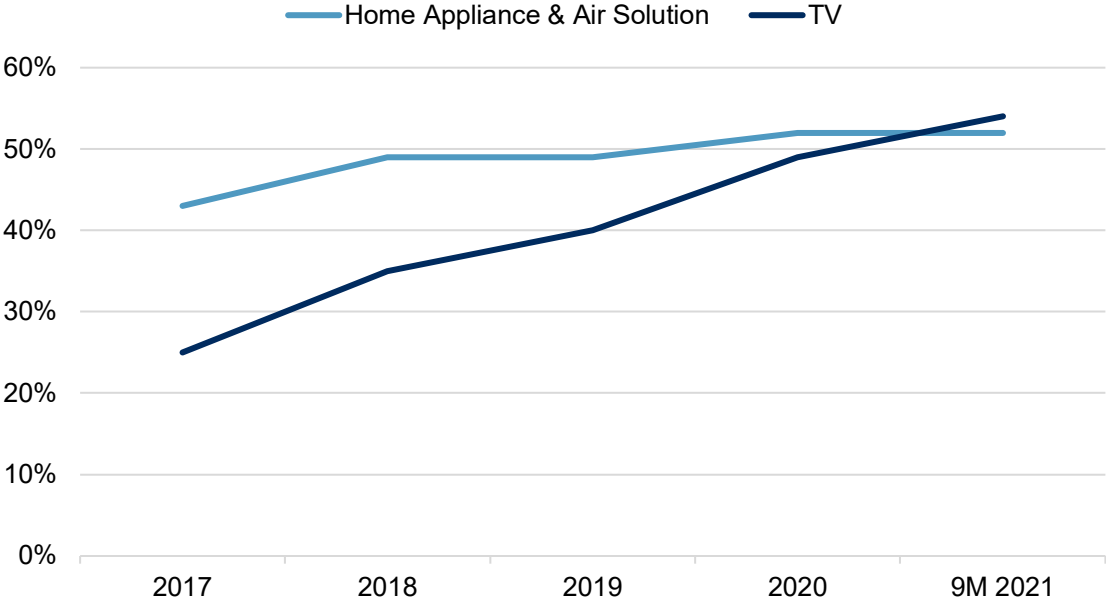
- Higher mix of premium consumer electronics is supporting LGE's strong operating performance.
- LG Display sustains robust performances since 2H20 owing to growing demand for display panels.
- We revised the outlook on LG Electronics to positive from stable in April 2021.

**LGE, LGD's Quarterly Operating Profits Back In Black**



Bil.—Billion. KRW --Korean won. Source: Company data, S&P Global Ratings.

**LGE's Increasing Premium Product Sales Portion**



Source: Company data, S&P Global Ratings.



# III. Autos:

## Resilient Despite Supply Chain Disruptions

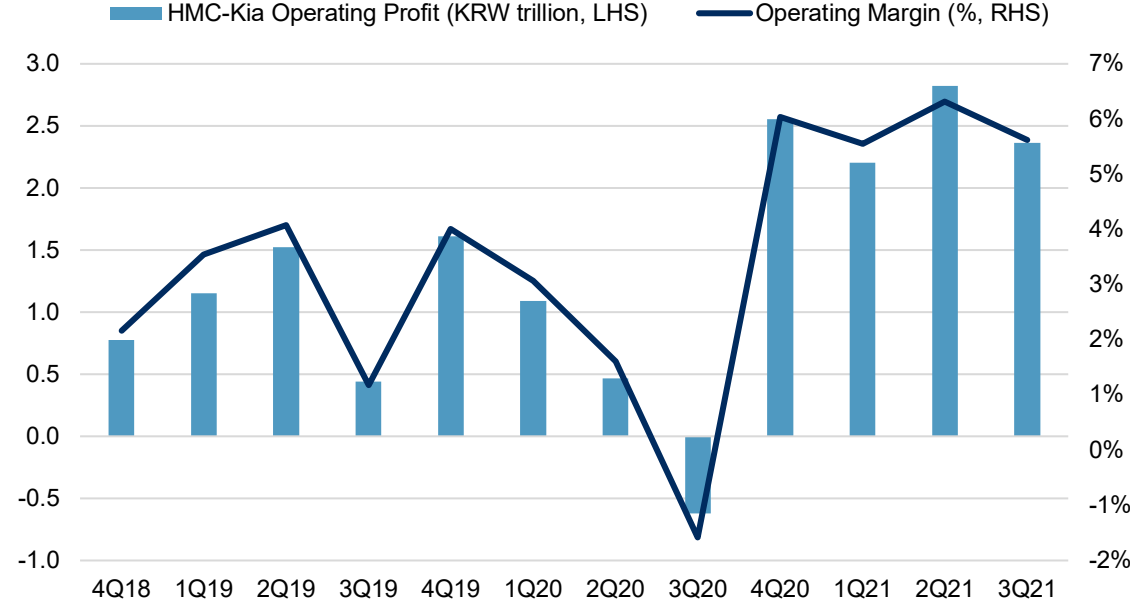
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# HMC-Kia Turning Around On Product Mix Improvements

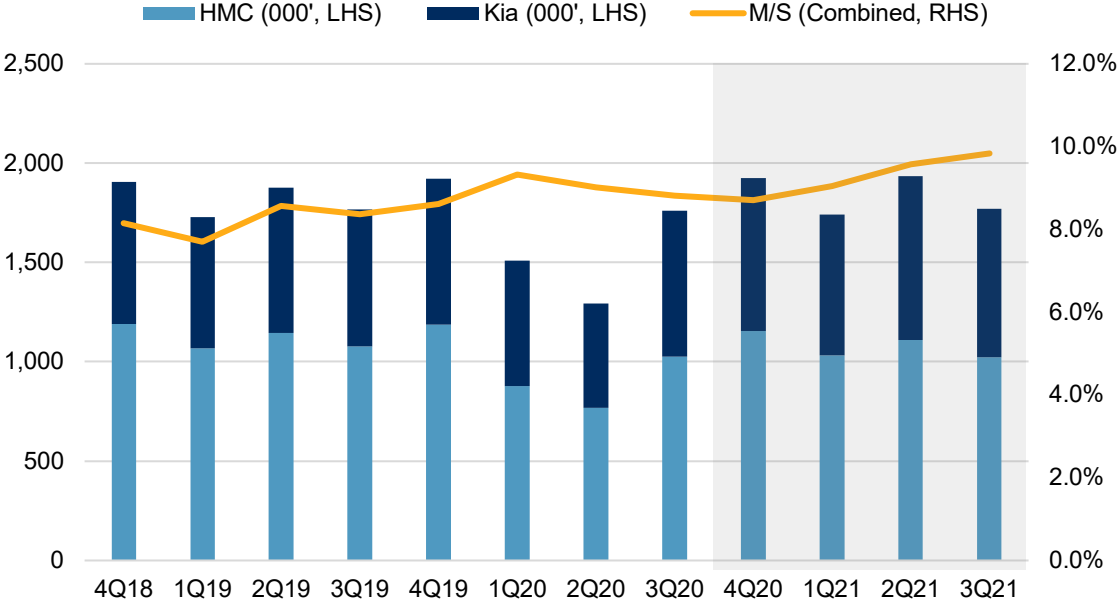
- HMC-Kia profitability improved substantially since 4Q20 on better product mix.
- HMC-Kia’s market share has increased on good sales in the U.S., Korea, Europe, and emerging markets.
- However, sales in China remained weak with limited recovery prospects over the next one to two years.

## Good Profitability Since 4Q20



Note: 3Q19 and 3Q20 results includes KRW0.7 trillion and KRW3.1 trillion one-off quality costs, respectively. KRW--Korean won. LHS--Left hand scale. RHS--Right hand scale. Source: Company Filings, S&P Global Ratings.

## HMC-Kia Gaining Market Share

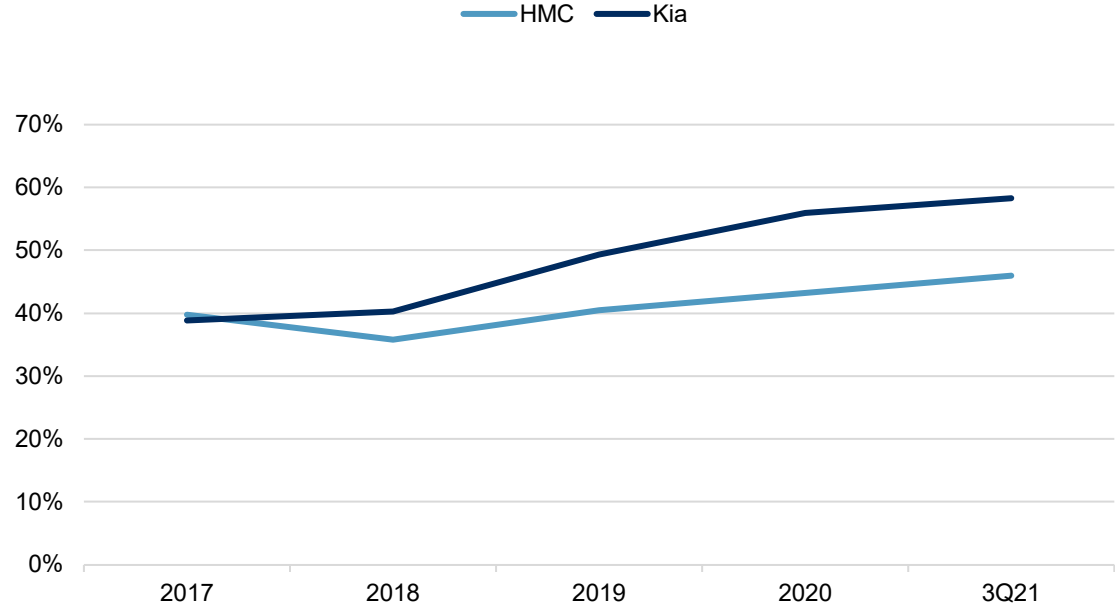


Note: LHS--Left hand scale. RHS--Right hand scale. Source: Company Filings, S&P Global Ratings.

# Increasing SUV Sales & New Premium Model Launches

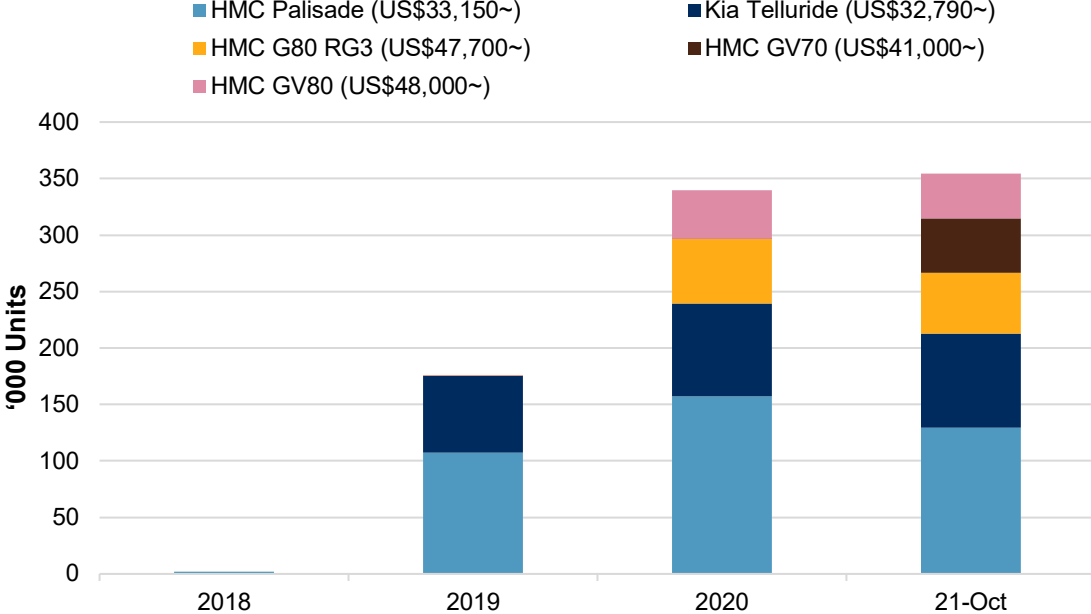
- Successful SUV line-up expansion and growth of premium brand (Genesis) are boosting performance.
- HMC-Kia saw strong ASP growth in both domestic and overseas markets.
- HMC-Kia's incentives in the U.S. market also showing a declining trend.

**SUV Sales Portion Increase For HMC-Kia (Volume Based)**



Source: Company Filings, S&P Global Ratings.

**New Premium Models Drive ASP Increases**



ASP--Average selling price. Source: Company Filings, S&P Global Ratings.

# HMC-Kia Outlook Revised To Stable On Improving Profitability

- EBITDA margin will be 8.0%-8.5% in 2021-2022, compared with about 5.2% in 2020 and 5.9% in 2019, supported by solid demand, continuous sales mix improvements and cost control measures.
- Uncertainty remains associated with (1) industry-wide chip shortage, (2) quality related costs, and (3) potential conflict with a labor union. However, the fundamental improvements will provide buffer against these risks.
- Key financial measures will likely remain solid. HMC and Kia together maintain a strong net cash position of over KRW20 trillion at the end of Sep 2021. We forecast HMC-Kia's discretionary cash flow to be around break-even in 2021-2022.



## Downside

We may lower the ratings on HMC and Kia if we downgrade the group credit profile. The group's auto business' (HMC including Kia) combined **EBITDA margin weakening below 8%** could lead to a downgrade. Some key contributing factors could be: (1) very severe production disruptions from chip shortage and pandemic-related restrictions; (2) market share erosion in the key markets; and (3) excessive financial(investments and higher costs) burden from green vehicle expansion.



## Upside

We may upgrade HMC and Kia if the group's global market position in the auto business strengthens. Auto's combined **EBITDA margin rising to more than 10% with market share gain, healthy inventory and incentive management, and successful green vehicles transition could drive such improvement.**

# **IV. ESG initiatives:**

## **Rising Emphasis On ESG Factors**

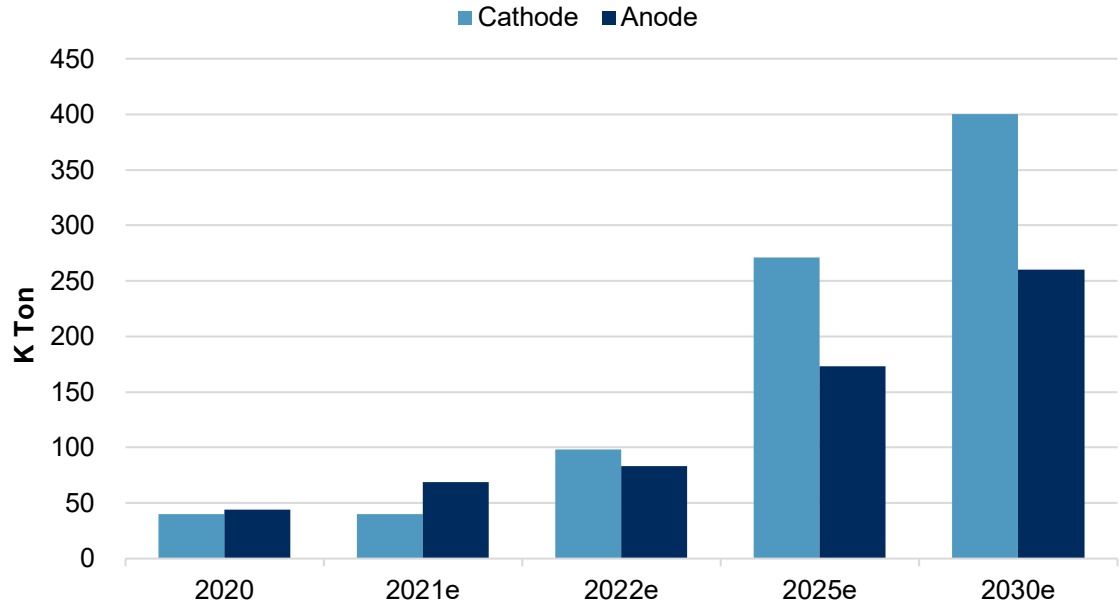
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# ESG Related Strategical Changes For Korean Corporates

- Major Korean conglomerates are making strategic changes in business portfolios, to expand into environmental-friendly business areas (i.e., POSCO - EV battery material, LG Electronics – EV automotive parts).
- Recent strong operating performances are supporting their business diversification into ESG related areas.

## POSCO Chemical – EV Battery Material Capacity Expansion (cathode/anode)



K Ton--1,000 tons. E--Estimate. Source: Company Filings, S&P Global Ratings.

## LG Electronics – Recent M&A transactions related to EVs

Transaction	Details
<b>JV with Magna (Jul. 2021)</b>	JV with Magna International (LG Magna e-Powertrain), which will provide <b>electric powertrains for EVs</b> (LGE's investment of about KRW500 billion)
<b>ZKW Group (2018)</b>	Acquired 70% stake of ZKW Group, Austria-based <b>automotive lighting and headlight systems</b> provider (about KRW1.1 trillion)
<b>Cybellum (Sep. 2021)</b>	Acquired 63.9% stake of Cybellum, an Israeli automotive cybersecurity startup, to strengthen its <b>automotive cybersecurity system</b> (LGE's investment of about KRW100 billion)

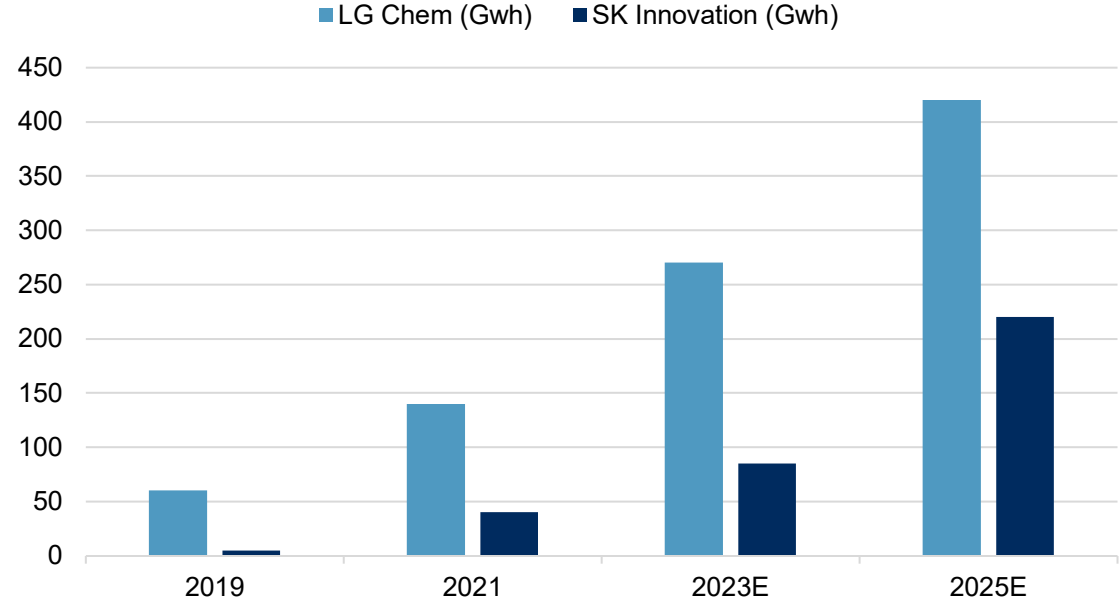
EV--Electric vehicles. Source: Company Filings, news reports, S&P Global Ratings.



# Business Portfolio Transformation On Korean EV Battery Makers

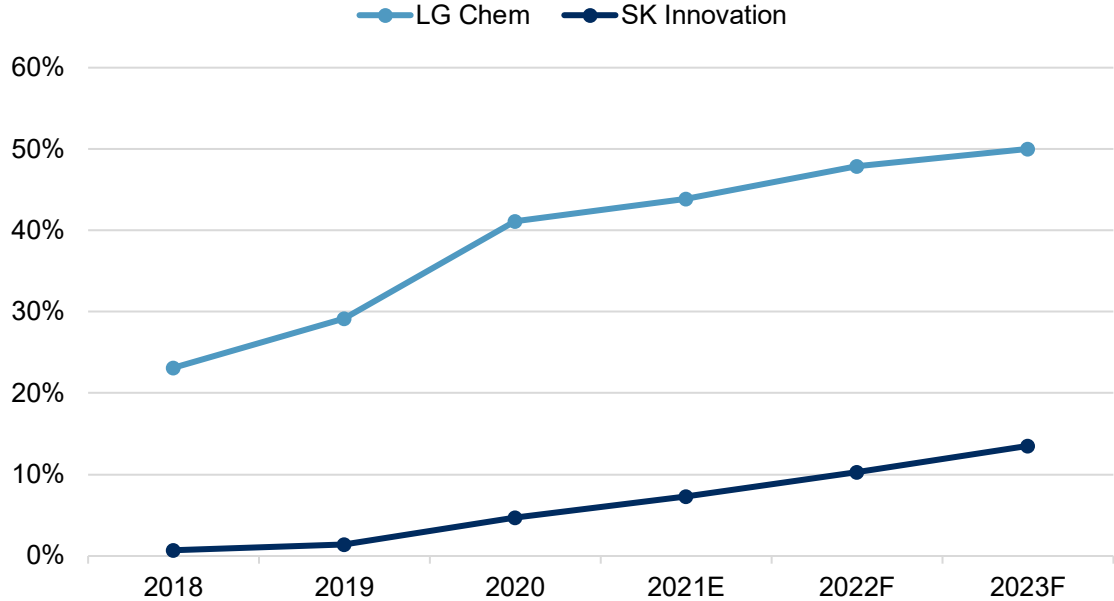
- Korean EV battery makers are aggressively investing on the back of close relationships with various global automakers.
- LG Chem and SK Innovation are rapidly shifting towards EV battery players from oil & chemical companies.
- Uncertainties remain on technological advancement, production stability, cost management, and supply-demand matching.

**Korean EV Battery Makers Aim To Triple Their Capacity By 2025**



Note: Capacity figures are mostly estimates, LG Solution is the electric-vehicle battery subsidiary of LG Chem. Technology Co. Ltd. E—Estimate. Gwh--Gigawatt hours. Source: Company filings, News reports, S&P Global Ratings.

**Revenue Contribution From Battery Business Is Rising**



E--Estimate. F--Forecast. Source: Company filings, News reports, S&P Global Ratings.

# SK E&S Shifting Focus To ESG Related Businesses

- SK E&S has shifted its business focus from 'LNG value chain' to 'hydrogen, renewable energy, and energy solution'.

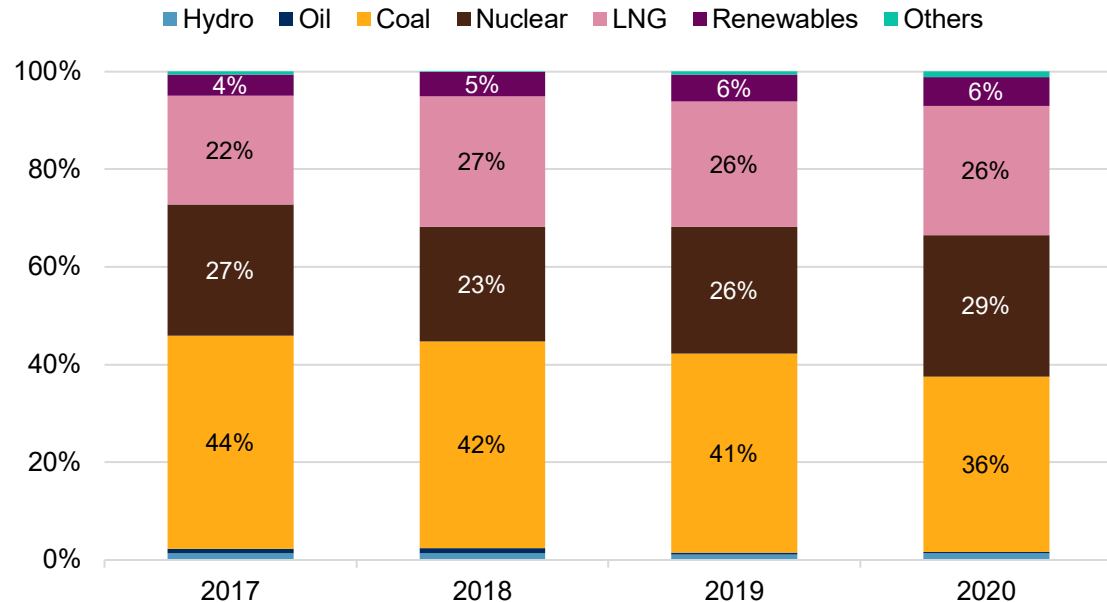
Area of business	Investment / Target
<b>Hydrogen</b>	<ul style="list-style-type: none"><li>– Spent US\$800 million to acquire 9.9% stake in U.S. hydrogen fuel cell systems provider Plug Power in Feb 2021.</li><li>– To invest KRW500 billion to build hydrogen liquefaction plants (annual capacity of 30,000 tons) by 2023, as part of SK group's plans to build a vertically integrated hydrogen eco-system.</li><li>– Partnered with Chinese state-owned power company Huadian, to expand its hydrogen business in China.</li></ul>
<b>Renewable energy</b>	<ul style="list-style-type: none"><li>– Targets to own 7GW of renewable energy (currently 2.5GW) and 1.2 million tons of carbon credits by 2025.</li></ul>
<b>Energy solution</b>	<ul style="list-style-type: none"><li>– Announced investment of US\$400 million in U.S. leading energy solution firm Rev Renewables in Oct 2021.</li><li>– Announced acquisition of 47% stake in parking control solution provider Parking Cloud at KRW179 billion in Nov 2021, to secure infrastructure for mobility energy solution business such as EV charging business.</li></ul>
<b>Green LNG</b>	<ul style="list-style-type: none"><li>– Korea's first supply of "carbon-neutral LNG" (1.3 million tons) produced by CCS technology by 2025.</li></ul>

Source: Company Filings, S&P Global Ratings.

# KEPCO Group Strongly Drives ESG Initiatives

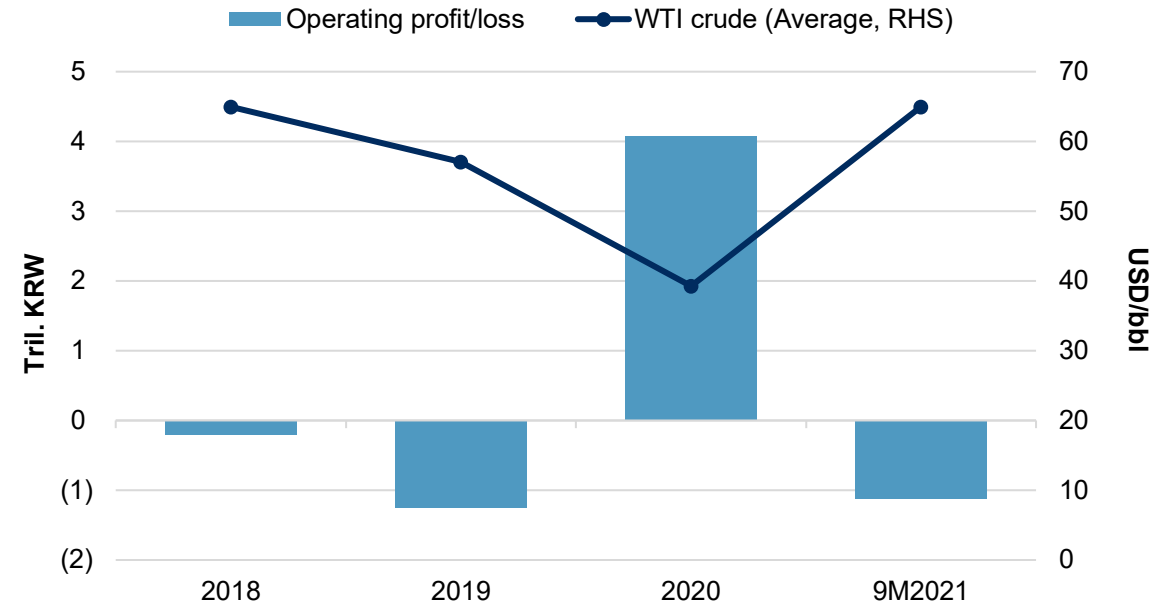
- Korean government focuses on reducing carbon emissions, plans to raise reduction target to 40% by 2030, from 26% previously.\*
- KEPCO aims to shift its power generation mix, replacing coal-based power to LNG and renewable energy.
- Changes in power generation mix and increase in raw materials price weighed on KEPCO's earnings.

## KEPCO Power Generation-Mix Is Getting Cleaner



Note: \*NDC (Nationally Determined Contributions), Oct 2021; carbon reduction target uses 2018 emissions volume as base. LNG--Liquefied Natural Gas. Source: South Korean Ministry of Trade, Industry and Energy, Company Filings, S&P Global Ratings.

## KEPCO – Operating Profit & WTI Trend

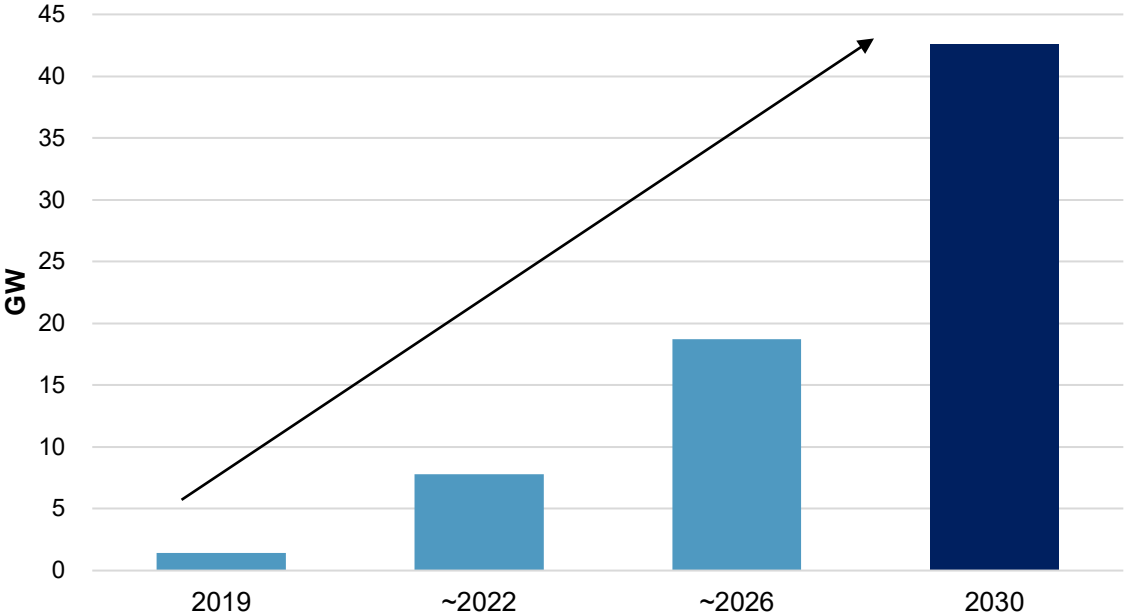


Tril.--Trillion. KRW--Korean won. USD/bbl--US Dollar per barrel. WTI--West Texas Intermediate. Source: Company Filings, Bloomberg, S&P Global Ratings.

# KEPCO's Aggressive Expansions Into Renewable Energy

- Company targets to increase power capacity from renewables over 30x by 2030 vs. 2019.
- Rapid shift in power generation mix and capex burden will likely weigh on KEPCO's financial metrics in the mid-term.
- S&PGR lowered KEPCO's stand-alone credit profile to 'bbb-' from 'bbb' in Oct. 2021 reflecting weakening profitability and financial metrics.

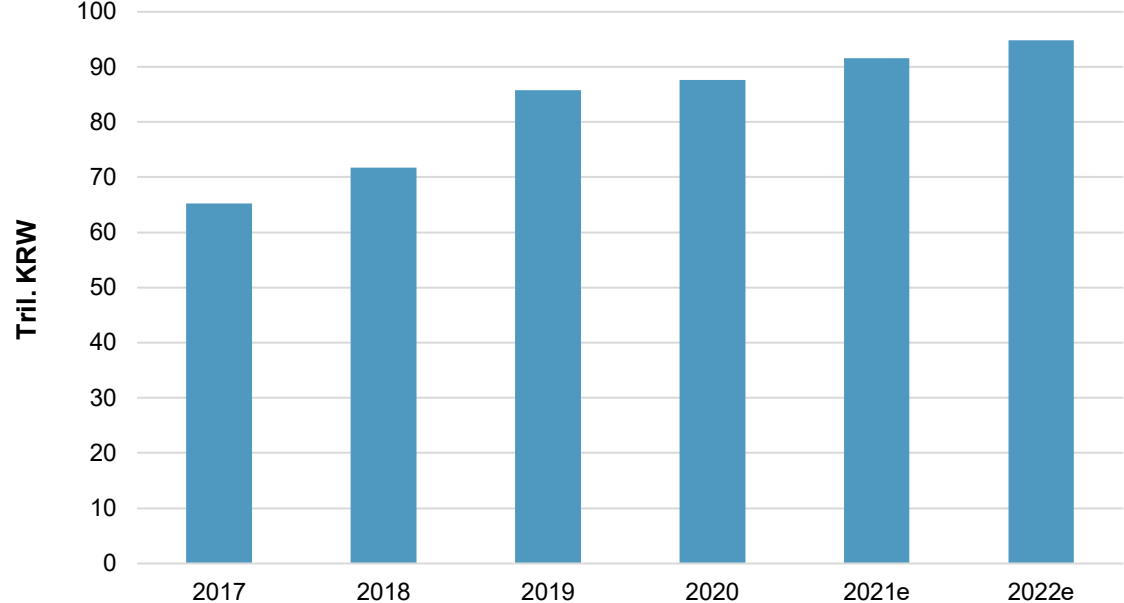
## KEPCO Renewable Power Target\* Points To Big Changes



\*Target capacity, based on KEPCO Group's RE3020 Roadmap. GW--Gigawatt. Source: Company Filings, S&P Global Ratings.

## KEPCO's Debt Burden Slowly Growing

Annual adjusted debt trend forecast



Tril.-- Trillion KRW --Korean won. E--Estimate. Source: Company Filings, S&P Global Ratings estimates.

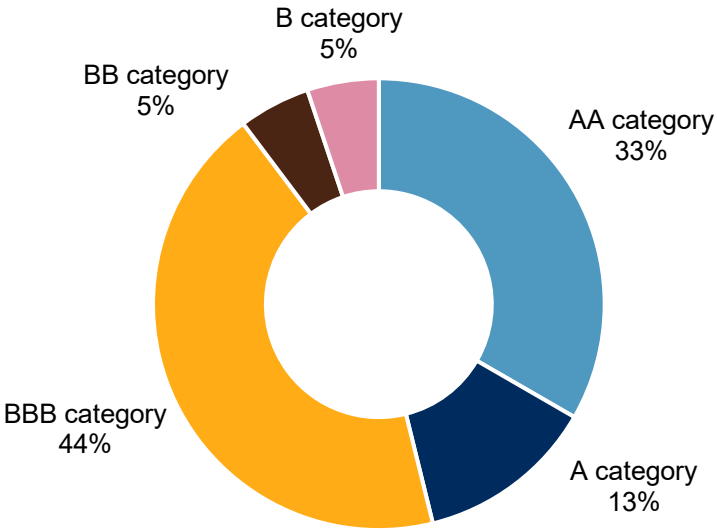
# **V. Conclusion:**

# **Balanced 2022 Credit Outlook**

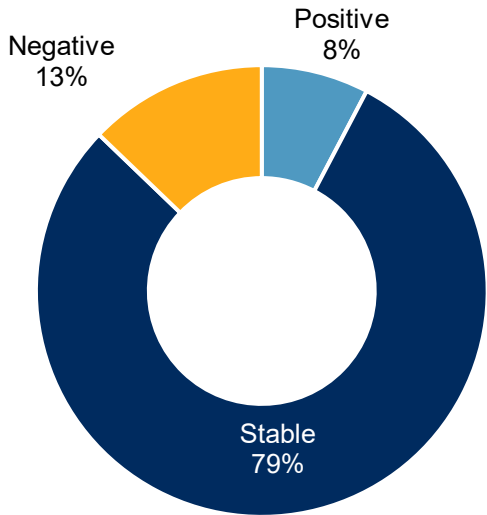
# More Balanced 2022 Credit Outlook Amid Ongoing ESG Drive

- Korean companies are focusing more on ESG related areas such as EVs, renewable energy, and hydrogen.
- Favorable operating environment, particularly for export-oriented manufacturers due to strong demand.
- Aggressive financial policy could weigh on creditworthiness for some companies such as SK Innovation and E-Mart.
- About 13% of Korean companies have a negative outlook, while positive outlooks increased to 8% of total.

## Rating Distribution



## Outlook Distribution



Note: As of Dec 1, 2021. S&P Global Rating rates 38 Korean companies including 13 government related entities (GREs). Source: S&P Global Ratings.



# Appendix. S&P Korean Corporate Rating and Outlook

Issuer	S&P Issuer Credit Rating	
	LT	Outlook
Samsung Electronics Co. Ltd.	AA-	Stable
KT Corp.	A-	Stable
SK Telecom Co. Ltd.	A-	Stable
SK Broadband Co. Ltd.	A-	Stable
Naver Corp.	A-	Stable
POSCO	BBB+	Positive
LG Chem Ltd.	BBB+	Stable
Hyundai Motor Co.	BBB+	Stable
Kia Corp.	BBB+	Stable
Hyundai Mobis Co. Ltd.	BBB+	Stable
Hyundai Glovis Co. Ltd.	BBB+	Stable
LG Electronics Inc.	BBB	Positive
Hankook Tire Co. Ltd.	BBB	Stable

Issuer	S&P Issuer Credit Rating	
	LT	Outlook
Hanwha Total Petrochemical Co. Ltd.	BBB	Stable
GS Caltex Corp.	BBB	Stable
S-Oil Corp.	BBB	Stable
Hyundai Steel Co.	BBB	Stable
SK Hynix Co. Ltd.	BBB-	Positive
SK E&S Co. Ltd.	BBB-	Stable
SK Innovation Co. Ltd.	BBB-	Negative
SK Global Chemical Co. Ltd.	BBB-	Negative
E-MART Co. Ltd.	BBB-	Negative
KCC Corp.	BB+	Stable
Doosan Bobcat Inc.	BB	Negative
Magnachip Semiconductor Corp.	B+	Stable
Hanjin International Corp.	B-	Negative

Note: As of Dec 1, 2021, Excluding the government related entities. LT--Long-term. Source: S&P Global Ratings.

# Thank you

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