

POSCO (005490)

Strategic Alliance to Enhance Bargaining Power in Iron Ore Price Negotiations

- POSCO announced that it would work together with Nippon Steel to conduct annual purchasing negotiations with iron ore suppliers. This is a follow-up measure to enhance its strategic alliance with Nippon Steel. This marks the first joint effort to procure raw materials by steelmakers from different countries.
- The stronger alliance between two steelmakers will help POSCO to better defend itself against rapid market changes such as the emergence of global giants through M&As like Arcelor Mittal.
- We maintain Overweight on POSCO with a target price of W320,000.

POSCO AND NIPPON STEEL TO JOINTLY CONDUCT IRON ORE PRICE NEGOTIATIONS

On October 20, POSCO announced a series of measures to strengthen its strategic alliance with Nippon Steel (Japan), including the exchange of steel slabs, cooperation in recycling ferruginous by-products, and expansion in cross shareholdings. The measures also included a plan to make joint investments to secure supplies of raw materials.

The follow-up measure was unveiled on December 11. POSCO released a plan to participate together with Nippon Steel in next year's iron ore contract negotiations, which takes place on April 1. Currently, the world's top three mining companies account for 79% of overseas iron ore trade, while the top five steelmakers represent a mere 17.5%. In addition, iron ore prices will likely continue to increase in 2007, as strong demand for iron ore has kept global supply very tight. Against this backdrop, the global steel industry should pay keen attention to see how effective the joint negotiations will be.

However, we are not sure the joint negotiations with the global mining giants will be effective in cutting down the price of iron ore, given the two steelmakers make up only 5% of the global market (around 3% each). Still, we believe that it is meaningful since it is the first joint raw material procurement effort by steelmakers from different countries.

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	3,839.8	3,134.0	35,945	-21.9	283.5	15.3	8.2	1.2	4.5
12/07F	20,103.5	3,717.6	2,850.5	32,694	-9.0	11.2	12.6	9.0	1.1	4.5
12/08F	21,065.4	3,378.8	2,538.1	29,111	-11.0	-238.9	10.2	10.1	1.0	4.6

Source: Company data, Daewoo Securities

Overweight

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Bloomberg: 005490 KS

Reuters: 005490.KS

Target price (6M): W320,000

Share Price (11/12/06): W293,000

Par Value: W5,000

52-W Lo/Hi: W192,500/299,500

KOSPI: 1,390.7p

Mkt Cap: US\$27.8bn/W25,545.7bn

Shares Issued: 87.2 mn shr

Avg Volume (60D): 242,441 shr

Avg Value (60D): US\$64.9mn/W59.7bn

Foreign Ownership: 62.2%

Dividend Yield (2005): 4.0%

Major Shareholder(s):

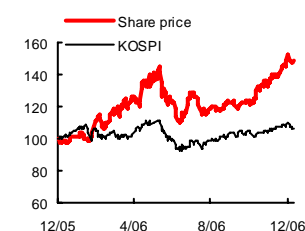
Bank of New York (22.62%)

SK Telecom (2.85%)

Price Performance

(%)	1M	6M	12M
Absolute	6.5	33.0	50.9
Relative	6.9	20.5	45.4

KOSPI Relative performance Chart



DETAILS OF STRATEGIC ALLIANCE WITH NIPPON ANNOUNCED IN OCTOBER

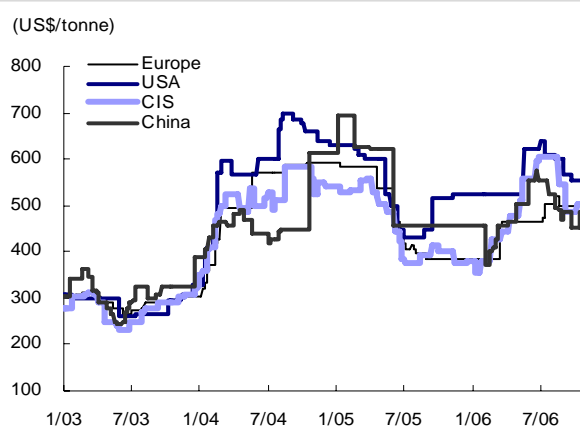
On October 20, POSCO and Nippon agreed to strengthen their strategic alliance by exchanging steel slabs, enhancing cooperation in recycling ferruginous by-products, and expanding cross shareholdings. POSCO also mentioned future plans to expand cooperation into other areas such as joint investments to secure supplies of raw materials.

First, POSCO and Nippon Steel agreed to supply steel slabs to each other for the next five years (2007–2011). As the first step, two companies will exchange 200,000 tonnes of slabs from February 2007 through March 2008, as a total of six blast furnaces are scheduled for repair. Additional exchange volume will be decided through future discussions.

Second, both steelmakers agreed to cooperate in recycling ferruginous by-products. POSCO will install rotary hearth furnaces (RHF)—developed and commercialized by Nippon—at its steel mills in Pohang and Gwangyang. The RHF will recycle into a raw material the ferruginous by-products produced during the process of manufacturing iron and steel manufacturing.

Third, both agreed to expand their capital alliance by increasing their cross-shareholdings. Nippon Steel will buy an additional 2% stake in POSCO (1.74mn shares), while POSCO will spend the same amount of capital on increasing its stake in Nippon. Currently, POSCO holds a 2.17% stake in Nippon, while Nippon has 3.32% of POSCO. The additional 2% purchase of 2% stake will be completed by March 2007.

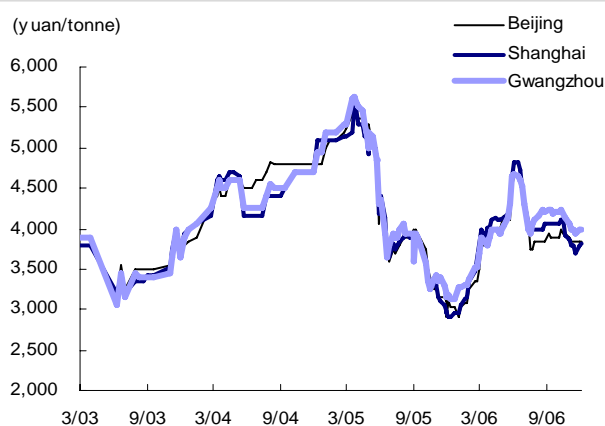
Chart 1. Global hot-rolled coil price trend



Note: CIS (Commonwealth of Independent States)

Source: Thomson Datastream, Daewoo Securities

Chart 2. Hot-rolled sheet spot price trend in China



Source: Thomson Datastream, Daewoo Securities

ENHANCED ALLIANCE: STRATEGY TO BETTER DEFEND FROM THREATS FROM GLOBAL GIANTS

On December 11, POSCO unveiled its plans for joint participation with Nippon in iron ore negotiations in two months after its announcement of strategic alliance expansion. The joint raw material price settlement is positive in that it can increase bargaining power and reduce raw material costs. However, we are not sure that the plan will be effective, given that the top iron ore producers—of BHP Billiton (Australia), Rio Tinto (Australia), and CVRD (Brazil)—holds a 79% market share. POSCO and Nippon Steel combined represent only 6% of the steel market.

However, we believe it is meaningful in that it marks the first joint raw material procurement effort by steelmakers from different countries. The alliance testifies both companies' commitment to mutual growth and development. In particular, increasing friendly shares should be positive for POSCO, which that could become an M&A target due to its large foreign shareholding of 62.2%.

Furthermore, the stronger partnership should help two companies to defend themselves amid big changes in the global steel market, such as emergence of global giants through M&As like Arcelor Mittal. The alliance between Asian steelmakers is thought to be part of their efforts to protect the Asian steel market from outside threats.

REASONS FOR RECENT POSCO'S RALLY

Recent rally of POSCO's shares is not based on solid fundamentals. Market conditions are unfavorable for steelmakers (see figure 2 and 3), and stock performance of local steelmakers is not strong. One positive note is that China's Baoshan Iron and Steel froze its domestic steel prices for 1Q07. But this is not enough to explain the recent strong performance rally in POSCO's shares stocks. What is the driving force behind it? There are four answers.

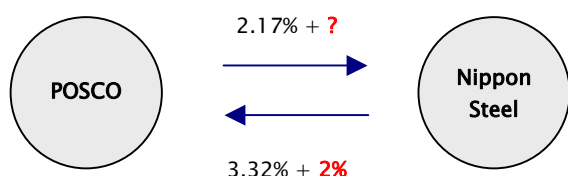
First, Nippon Steel is buying DRs of POSCO in overseas markets, giving a boost to local share price. Nippon will purchase 2% of POSCO (1.74mn shares) in New York and London by March 2007.

Second, POSCO is buying back 30,000 treasury shares on a daily basis. The share buyback keeps the share price from sharply falling.

Third, DRs are showing strong performance in keeping with a rally of steel stocks in the U.S. and Europe. The rally is being fueled by high possibilities of M&As for Corus (Britain) and US Steel (US). The M&As have been widely anticipated in the steel market since the launch of Arcelor Mittal. In addition, POSCO's attractiveness as an M&A target (62.2% of foreign ownership) has been priced in the current stock price.

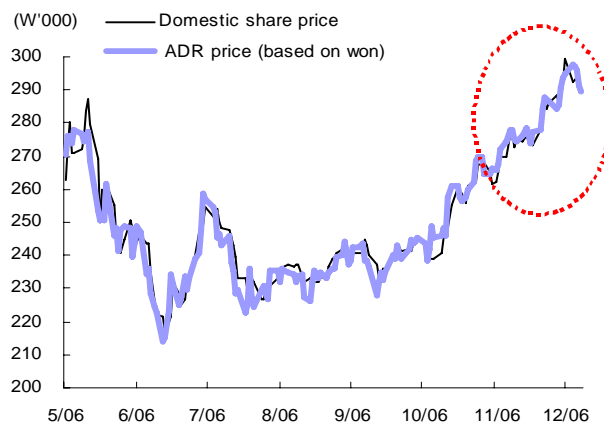
Fourth, Baoshan and other large steelmakers are pushing to be listed on the overseas markets in order to finance their capex expansion. This resulted in strong stock performance of not only large Chinese large steelmakers but also China Steel (Taiwan), Nippon Steel (Japan), and POSCO (Korea).

Chart 3. Cross Shareholdings between POSCO and Nippon Steel



Source: Companies data, Daewoo Securities

Chart 4. POSCO's ADR price and domestic share price



Source: Thomson Datastream, American Depositary Receipts (ADR), Daewoo Securities

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As of December 12, 2006, Daewoo Securities Co., Ltd. has acted as a liquidity provider for equity-linked warrants backed by shares of POSCO as an underlying asset, and other than this, Daewoo Securities has no other special interests in the covered companies.

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 December 11, 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.

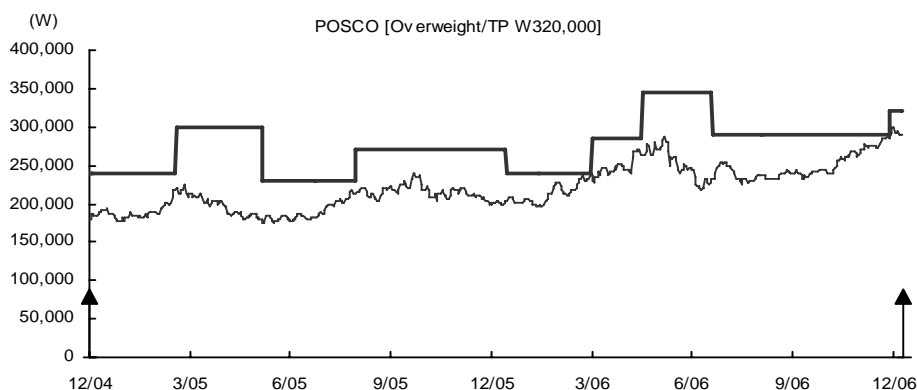
Source: Daewoo Securities

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 (⊞), Overweight (▲), Trading Buy (■), Equal-weight (●), Under-weight (◆)



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