

Park and drive... into the wall!

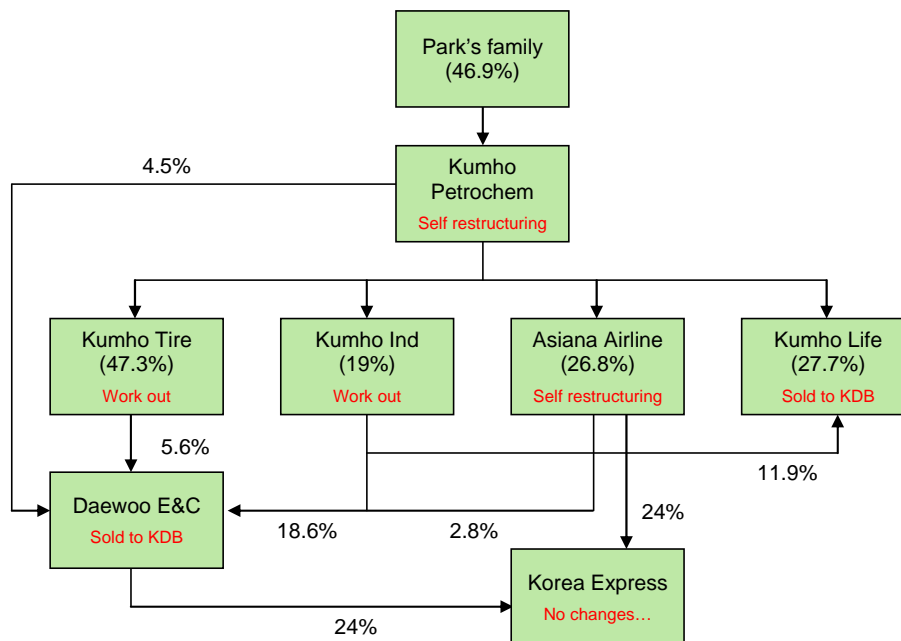
Too much greed may kill the long history of a Korean Chaebol - Kumho Asiana Group.

February 2010 - Author: KR Min, Senior Research Analyst.

Who is the Kumho-Asiana Group?

Kumho-Asiana ("the Group") started in 1946 by establishing a small company called "Kwangju Taxi" based on two second hand American taxis. The company followed the name of the city in the south western (Honam) province of Korea and ever since has been a representative from the south western province in the Korean business society. They have expanded their business area via either new start-ups or acquisition; Kumho Express, 1948, Kumho Industrial/Tire, 1960, Kumho Petrochem, 1970, Asiana Airlines, 1988, Daewoo E&C, 2006 and Korea Express, 2008 (the current Kumho Tire was actually spun off from Kumho Ind in June 2003). The honorary Chairman, Mr. Park, Sam-Gu, is the son of the founder of the Group.

Kumho-Asiana Group structure



Source: BofA Merrill Lynch

The Group consisted of four business areas – chemical/tire, airlines/logistics, construction and financial -with 21 companies, some of which are about to leave the Group, though.

Starting from two taxis 64 years ago, the consolidated shareholders funds increased up to KRW1.8tn (consolidated asset of KRW10.2tn) at 2008 end. Consolidated P/L in 2008 showed sales of KRW7.2tn, EBIT W400bn and net loss of W166bn due to a high gearing ratio. The net interest-bearing debt ratio was 360% with gross debt W6.6tn and cash W204bn (gross debt amount didn't include contingent liabilities of "put option" at the time of Daewoo E&C acquisition).

The old Ford – the same model as the first two taxis



Source: www.naver.com

Given that the Group is the de-facto business representative in Honam Province, workout or restructuring of the businesses (or let-go of some businesses) may have negative political implications as well, apart from economic reasoning. The Group was ranked at 8th out of Korean Chaebols in terms of assets, but certainly not any more, going forward.

What were the problems?

Acquisition of Daewoo E&C

It was December 2006 when the Group closed the deal to acquire a 72.1% stake in Daewoo E&C from KAMCO (Korea Asset Management Corporation – a Government agency for collecting non-performing loans), spending W6.5tn. There were other local bidders – Doosan Group (bidding price of c. W5.5tn for 50%+1 share, not 72%), Prime Group (c. W6tn), and Eugene Group (c. W6tn), who were all regarded lucky not to have been chosen. However, most of the bidders suffered quite a lot during the global downturn in '08-'09.

Daewoo E&C under Kumho-Asiana



Source: Yonhap News Agency



Funding structure

The Group paid total of W2.9tn and the remaining of W3.5tn funding was from investments by FIs (Financial Investors) as shown below. However, a significant portion of the money paid by the major four companies of the Group – Industrial, Tire, Petrochem and Asiana – was raised by increasing leverage. Combined net debt of four companies at 2005 end was c. W4.1tn, but it went up to c. W6.6tn at the end of 2006 after the acquisition, increasing the gearing ratio sharply from 110% in '05 to 171% in '06.

Change of combined gearing ratios of Industrial, Tire, Petrochem and Asiana (Before vs. After)

(Wbn)	2005-end	2006-end	YoY
Total Asset	10,487	12,749	2,262
Net Debt	4,073	6,638	2,564
Shareholders Equities	3,706	3,887	180.5
Gearing Ratio	110%	171%	55%

Source: CLSA

The increased portion of net debt has mostly come from higher leverage through more bank lending and issuance of corporate bonds. Furthermore, the Group has additional liabilities regarding the FIs.

Investment Structure in Daewoo E&C

Investors	Ownership	Investment Size
Kumho Group	32.50%	W2,894.6bn
Kumho Ind		W1,645bn
Kumho Tire		W500bn
Kumho Petrochem		W400bn
Asiana Airlines		W250bn
Kumho Life		W100bn
Financial Investors	39.60%	W3,531bn
Mirae Asset PEF	6.80%	W610bn
Pangaea Deca	5.60%	W500bn
Tongyang Sec	3.80%	W340bn
Kookmin Bank	3.40%	W300bn
Woori Bank	3.20%	W290bn
Hana Bank	2.20%	W200bn
IBK	2.20%	W200bn
Shinhan Bank	1.10%	W100bn
Shinhan Capital	0.20%	W20bn
Others	11.10%	W971bn
Total	72.10%	W6,425bn

Source: CLSA

Some of the investors - securities companies and private equity funds - have already exited via issuing ABS.

Terms and conditions with FIs

Payment Guarantee: W3.5tn invested principal by FIs were guaranteed by the Group at a 9% annual interest rate with 3 year maturity. Or...

Put back option: if the share price of Daewoo E&C is under W32,500/share (=the equivalent stock price for guaranteeing 9% yield per annum) at maturity, the Group has to purchase the shares from the FIs at the market price. The shortfall amount at the end of 2009 seemed to be c. KRW2tn (=40% stake x price difference of [W32.5K/share – W18K/share]) and c. W4.2tn including the original investment by FIs due by June 2010.

Increased indebtedness and a contingent liabilities burden have made the Group more worse off during the global downturn. Severe restructuring and a re-sale of Daewoo E&C are essential for survival.

Acquisition of Korea Express

After having acquired Daewoo E&C, the Group also purchased a 60% stake in “Korea Express” for W4.1tn in March 2008 - No 1 logistics company in Korea that had been under court protection since June 2001: another legacy of the financial crisis of a decade ago. Korea Express is 50% owned by the Group (including Asiana 24% and Daewoo E&C 24%) and the remaining 10% is owned by other small investors. Had it not been for the workout process, the Group might have tapped the market for selling Korea Express as well. The chance is still open... in theory.

Counter examples – lesson from other Chaebol

Here are some (counter) examples that managed to avoid Kumho-Asiana's fate during global crisis.

Hanwha Group was the preferred bidder for the acquisition of DSME (Daewoo Shipbuilding & Marine Engineering) in 2008. However, affected by global financial recession, Hanwha Group failed to persuade financial investors to join the bid as well as failing to raise finance by themselves via selling their assets. The security deposit of c. W300bn paid to KDB (Korea Development Bank) and KAMCO for the acquisition is now in dispute between the sellers and the preferred bidder. When Hanwha submitted the bid, market capitalization of DSME was c. W7tn in the summer of 2008, but it came down to W2.7tn at the end of 2009. Given that Hanwha intended to acquire a 50%+ stake at DSME, they could have saved, in theory, c. W2tn without considering the management premium but despite this, they wasted W300bn cash for not taking the deal.

A similar story can be found in Dongkuk Steel Mill (DSM)'s attempt to acquire Ssang Yong E&C (a construction arm of old Ssang Young Group before Korean financial crisis a decade ago). The first attempt to sell Ssang Young E&C by creditors began in June 2007 and it took c. 1.5 years to see the deal nullified. DSM was willing to pay c. W460bn (they would pay KRW31K per share, including management premium) but the share price collapsed to c. KRW6K (1/5 of the original deal amount) when they abandoned their right to purchase the company. The associated cost was KRW24bn for the key money and it is the subject of a legal dispute as well.

Nobody would know what would have happened if the two deals have been signed. However, assuming the similar deal structure like Kumho-Asiana, two cases might have followed the similar paths that Kumho-Asiana took.

Restructuring of Kumho-Asiana Group

The restructuring process will begin by combining a workout program, self restructuring and sale of assets/affiliate. The largest shareholder, Park family, will have to surrender their stakes in Petrochem (46.9%) and Industrial (8.2%) to the creditors as collateral for successful implementation of the restructuring effort.

Red light on Kumho-Asiana



Source: Yonhap News Agency

Work out

The two most heavily geared companies (Industrial and Tires) started their workout program led by creditors effective from January 6, 2010. Creditors will have due diligence for two months to draw the detailed map for the workout program and to set the terms and conditions for the workouts with the Group in April. Re-scheduling of debt profiles, haircuts, provision of new loans, debt-equity swaps, lay offs etc. will be discussed. In the mean time, all standstill of existing debt will be effective for three months (by March 30 for Industrial and by April 16 for Tires).

Self restructuring – lay offs ...etc

The business environment for Petrochem and Asiana look to have bottomed out from the global downturn in 2009 and especially, backed by strength of KRW and pent-up demand on outbound traveling, Asiana have been in the way of sharp improvement. However, two companies have to put themselves into self restructuring programs to reduce their gearing ratios and to pay contingent liabilities.

20% lay offs and 20% salary cut of the management, mandatory monthly vacation without being paid for the employees, reduction of benefits, lay offs etc. are the typical menu under self-restructuring.

Re-sales of Daewoo E&C to KDB

For the last couple of months the Group has tried to sell the stake at Daewoo E&C to anybody showing interest but failed. KDB is the only counter party who can purchase the shares, locking loss and providing fresh money to the Group. KDB is to purchase a “50%+1 share” to control the management right for future re-sale via a private equity structure with other financial investors. Therefore, the original FIs for Daewoo E&C who are demanding KDB’s purchase at the price of W35K/share have to admit whatever negative condition provided by KDB. It is expected that KDB’s offer price would be close to W18K/share (40% premium to the current price of W12.5K/share, but 50% discount to the guaranteed price).

Sales of Kumho Life

KDB will set up a separate PEF (private equity fund) to purchase Kumho Life shares as a method of providing fresh money into the Group. NPS (National Pension Service) will be a major investor for the PEF, willing to pour up to W260bn for the deal, followed by Consus Asset Management Company, one of whose major shareholders is Kumho Life (!). Korean Re wants to be an investor for the PEF, with allegedly hoping for a life insurer in the long run.

Asset sales

The estimated proceeds amount from sales of assets owned by four companies will be up to W1.3tn, according to the Group, but it will take time to monetize them. One of the recent news flow is that the preferred bidder for purchasing the “Seoul Express Bus Terminal” from Industrial made a failure in settling the deal; no payment of W270bn to Industrial. Industrial should start the entire process from the beginning again.

When the Group was announcing restructuring plan with KDB



Source: Money Today

Troubleshooting

Financial investors into Daewoo E&C were not happy to accept the workout program initiated by KDB and want to set their own voice to restructure Industrial, Daewoo and other affiliates. They don't accept KDB's plan of a debt-equity swap into Industrial shares; the shortfall amount between the guaranteed price and KDB's offer price should be swapped into Industrial's shares. FIs are concerned about the accrued interest amount – basically they don't want to give up what they were guaranteed by the Group.

The family of the Group are supposed to surrender their private assets as collateral to fulfill the entire restructuring but it's not going smoothly yet.

KDB should coordinate all this troubleshooting, but it will definitely take time to make many participants less disappointed. Time is critical to restructuring, but... due diligence will take 2-3months for drawing the big picture and actual implementation of workout and restructuring will be from early/mid of 2Q10. Successful recoveries will be also related to the recovery of global economy, especially Petrochem and Asiana.

Impact to the market

The possible struggling of the Group has been widely expected in the market during the last couple of months and the actual impact to financial markets was not big enough so far. Relatively speaking, Kumho was rather small in terms of indebtedness compared with Daewoo's trouble in early 2000: Daewoo's total financial liabilities were W80tn vs. W18tn for Kumho.

The other reason for a relatively smaller impact is that it broke out in the time of recovery from the global recession – especially since Korea has been recovering very fast – and it does have minimal impact to the economic system. Various experiences on workouts and restructurings since the Asian financial crisis are working effectively for the creditors to make their own decision rather quickly.

Korean regulators want to cut the spread-out of negative impact throughout the economic system, confining losses to the creditors and financial investors as well as the employees of the Group. So far, it has been working.

Nonetheless, banks are bleeding somewhat...

Banks' exposure to Kumho-Asiana Group

(KRW bn)	Exposure - excluding investment in Daewoo E&C
Woori Bank	1,610
Kookmin Bank	640
Hana Bank	600
KEB	400
Shinhan Bank	300
IBK	130
Others	144
Total	3,824

Source: CLSA

According to CLSA's forecast, the assumption of 20%-50% write-down for the loan made to Industrial and Tires and 7%-20% write-down to Petrochem and Asiana would require the total provision amount of W420bn-W1.1tn to the banking sector, apart from the loss with respect to the investment into Daewoo E&C. Macquarie Securities estimated the possible provision from the loans would be W620bn (assuming 25% write-down), which is c. 5% of 2010E aggregate earnings. Merrill Lynch is estimating a similar impact to the balance sheets of banks in 4Q09: W600-W700bn provisioning burden.

Depending upon the reset of the workout and restructuring, the long term impact wouldn't be as bad as initially feared.

Closing

It didn't take a long time to collapse the entire structure of the Group, putting back the shape of the Group before the acquisition of Daewoo E&C – actually it went further backward because the largest shareholder (Park's family) had to put up their shares of Petrochem (de-facto the Holding company) and Asiana Airlines as collateral. Once the restructuring doesn't go smoothly as planned, the Park's family may lose the significant portion of the management control over the Group, in theory. One of the threatening examples is the suggestion by FIs exposed to Daewoo E&C to further invest into Industrial, aiming at controlling the most of the Group.

The Group's complete recovery from the workout and restructuring programs looks quite distant at this point, given that the creditors just started to conduct due diligence for setting up road maps for the main four companies. Obviously, actual recoveries of each company are dependent upon how fast the global economy is stabilised. In fact, outbound travel demand and cargo demand are working favourably to Asiana business. Kumho Petrochem's business environment won't be looking deteriorated going forward; in fact they will benefit from increasing demand on chemical products. However, the business sentiments for tire and construction are far from looking good at the current stage.



In some sense, it would be lucky to get much support by KDB and other financial creditors to draw a common conclusion in a short period of time and to cut any spill-over impact to other economic sectors. When do they come back? It's too early to forecast any time horizon, even if all four companies are properly restructured quickly. At least, for the time being, it will be difficult to fulfill the Group management's philosophy of "contribution to country and society" and the goal "to become industry leaders in creating value", given that they have to let many employees leave the Group earlier and to shrink their business.

The management was so blind that they couldn't see the risks behind the stretched acquisition or expansion. They seemed to be too greedy to detect and control the entire risks associated with business development. Too much greed combined with significant leverage does bring lots of cost that should be born by not only the management, but also by all related parties, including employees as well as lenders and shareholders.

Kumho-Asiana Group's failure to take off will provide a good lesson along the development of Korean corporations.