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Hankook Tire & Technology Co., Ltd.

Announced acquisition of Hanon Systems increases diversification but raises leverage

On 3 May, Hankook Tire & Technology Co., Ltd. (HKT, Baa2 stable) announced it had signed a memorandum of understanding with private-equity firm Hahn & Company to acquire an additional 25% stake in Hanon Systems Co., Ltd. for KRW1,367 billion. HKT will also concurrently pay KRW365 billion to purchase new shares that Hanon Systems will issue. The transactions are subject to due diligence and regulatory approvals and would increase HKT's stake in Hanon Systems to 50.5% from the current 19.5%.

The proposed acquisition of Hanon Systems' leading automotive thermal management systems business will significantly enhance HKT's scale and business diversification. However, the acquisition will increase HKT's financial leverage and weaken its profitability when Hanon Systems' high financial leverage and moderate profitability are consolidated into HKT's accounts.

HKT can fund the total equity consideration without significant debt because it had around KRW2.8 trillion cash on hand as of 30 March.

However, the consolidation of Hanon Systems would raise HKT's consolidated leverage, because of Hanon Systems' high adjusted debt/EBITDA of around 7.0x for 2023. This measure partly reflects the company's high development spending, which we treat as a cost item instead of capitalized investment.

We estimate HKT's gross adjusted debt/EBITDA will increase to around 2.3x-2.5x on a pro forma basis for the next one to two years from 0.6x in 2023. At the same time, the consolidated entity will maintain large cash holdings, leading to net leverage of around 1.5x during the same period, compared with HKT's current net cash position.

The acquisition will lower HKT's consolidated profitability from the currently high levels, because of Hanon Systems' lower profit margin. Hanon Systems' adjusted EBITA margins were 2%-5% over the past five years, compared with HKT's 9%-15%.

Hanon Systems has a strong competitive profile as one of the world's largest suppliers of thermal management systems. The company has a long history of operating a geographically diversified business based on established relationships with major global auto companies.

The acquisition will therefore substantially strengthen HKT's scale and business diversification. On a pro forma basis based on 2023 results, Hanon Systems would account for half of HKT's consolidated revenue and one-quarter of its adjusted EBITDA.

As the transaction progresses over the next quarter, we will monitor HKT's funding mix and strategies around Hanon Systems. Specifically, our monitoring will focus on how HKT will balance Hanon Systems' business growth against its elevated financial leverage and achieve synergies between the two somewhat distinct businesses.

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