HOA PHAT GROUP JSC (HPG – HSX)

Unmatchable

Particulars (VND bn)	Q3-FY16	Q2-FY16	+/- QoQ	Q3-FY15	+/- YoY
Net revenue	8,142.1	8,048.2	1%	6,845.2	19%
PAT	1,604.8	2,025.8	-21%	1,032.2	55%
EBIT	1,924.8	2,449.1	-21%	1,226.3	57%
EBIT margin	23.6%	30.4%	-679bps	17.9%	573bps

Sources: HPG, RongViet Research

Q3/2016 Performance: Steel Business Contributed to over 90% of NPAT

- Maintaining the highest market share in both the rebar and steel pipe segments
- Minimising coking coal's impact through its well-managed inventory
- Benefiting from Anti-dumping duties against imported billets

Q4 2016 and 2017 Potential: Industry's Top Performer Despite Input Price Surge

Basic oxygen furnace(BOF) No. 3, which has a capacity of 750,000 tons per year and began its operations during Q2 2016, has increased HPG's steel production capacity to over 2 million tons per year. Since HPG is the only domestic producer equipped with the above mentioned production method, HPG is capable of retaining a gross margin that exceeds its industry peers.

In addition to rebar, HPG also sells billets to other producers since the company is able to offer a competitive price as compared to imports. HPG has also started receiving orders from North American markets, taking advantage of the vacancy of Chinese producers left in the market due to the AD activities. Moreover, the company began to supply steel products of other applications, which it previously imported.

Input material prices have surged for the last 9 months, which has significantly increased the costs for most steel makers. Therefore, HPG's 2017 gross margin is forecasted to be lower than its gross margin in 2016, although it is still likely to prevail over the industry.

Valuation and Recommendation*: Although it is affected by the rise of input prices, HPG is expected to maintain its top position in terms of production and consumption in the steel industry in 2017. Thanks to the growing domestic demand and a solid market price level supported by the countervailing measures, HPG can overcome the negative impacts of soaring coking coal and iron ore prices. RongViet Research forecasts that HPG is capable of keeping its gross margin above 20% amid the fluctuating input prices that are occurring due to China's industry reforming activities.*

Using FCFF and P/E, we determine HPG's target price to be around ***VND 50,300*** *per share,* ***19.8%*** *higher than the closing price on November 21st 2016. The new target price is revised from our Company report on January 15th 2016 based on the industry's performance during this year and its potential in 2017. Therefore, we recommend investors to* ***ACCUMULATE*** *in the* ***LONGTERM****.*

** EPS based on 2016's weighted average OS.*

ACCUMULATE

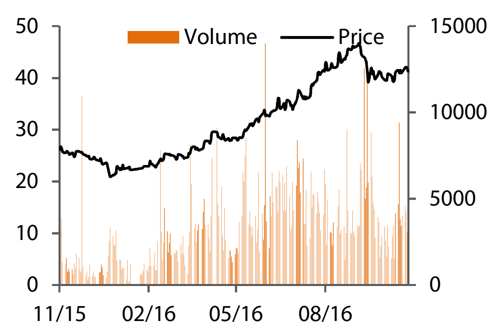
CMP (VND)	42,000
Target Price (VND)	50,300
Investment Period	**Long-term**

Stock Info

Sector	Basic materials
Market Cap (VND B)	35,396.17
Current Shares O/S	842,766,000
Beta	1.24
Free float (%)	47.8
52 week High	46,700
52 week Low	20,905
Avg. Daily Volume (20 sessions)	3,506,829

	FY15	Current
EPS*	4,404	6,189
EPS Growth	18.06%	55.53%
Diluted EPS	4,404	6,189
P/E	8.83	6.78
P/B	2.13	1.97
EV/EBITDA	6.20	4.76
Cash dividend (on par)	3.57%	3.57%
ROE	25.23%	32.61%

Price performance



Major Shareholders (%)

Trần Đình Long	21.87
Vũ Thị Hiền	6.34
Dragon Capital	5.11
Foreign ownership room (%)	13.17

Trinh Nguyen

(084) 08- 6299 2006 – Ext 1331

trinh.nh@vdsc.com.vn

Exhibit 1: 3QFY2016

Particulars (VND bn)	Q3-FY16	Q2-FY16	+/- (QoQ)	Q3-FY15	+/- (YoY)
Net Revenues	8,142.1	8,048.2	1.2%	6,845.2	18.9%
Gross profits	2,116.9	2,571.5	-17.7%	1,560.5	35.7%
SG&AC	219.5	169.1	29.8%	241.1	-9.0%
Operating Income	1,857.5	2,362.6	-21.4%	1,149.7	61.6%
EBITDA	1,935.1	2,545.1	-24.0%	1,522.6	27.1%
EBIT	1,924.8	2,186.2	-12.0%	1,226.3	57.0%
Financial expenses	83.2	94.8	-12.2%	232.0	-64.1%
- Interest Expenses	69.1	67.3	2.6%	65.7	5.2%
Dep. and amortization	-10.3	-358.8	-97.1%	-296.3	-96.5%
Non-recurring Items (*)					
Extraordinary Items (*)	1.8	19.1	-90.8%	10.9	-83.9%
PBT	1,855.7	2,381.8	-22.1%	1,160.6	59.9%
PAT	1,604.8	2,025.8	-20.8%	1,032.2	55.5%
(*) Adjusted PAT	1,603.3	2,007.3	-20.1%	1,022.5	56.8%

Sources: HPG, RongViet Research

Exhibit 2: 1QFY2016 Performance Analysis

Particulars	Q3-FY16	Q2-FY16	+/- (QoQ)	Q3-FY15	+/- (YoY)
Profitability Ratios (%)					
Gross Margin	26.0%	32.0%	-595bps	22.8%	320bps
EBITDA Margin	23.8%	31.6%	-786bps	22.2%	152bps
EBIT Margin	23.6%	27.2%	-352bps	17.9%	573bps
Net Margin	19.7%	25.2%	-546bps	15.1%	463bps
Adjusted Net Margin	19.7%	24.9%	-525bps	14.9%	475bps
Turnover *(x)					
-Inventories	3.0	3.0	-0.1	3.3	-0.3
-Receivables	18.0	18.4	-0.4	16.3	1.7
-Payables	2.6	2.4	0.2	2.4	0.2
Leverage (%)					
Total Debt/ Equity	57.6%	57.9%	-0.3%	74.9%	-17.3%

Sources: HPG, (*) Annualized turnover

Exhibit 3: 4QFY2016 Performance Forecast

Particulars (VND bn)	Q4-FY16	+/- (QoQ)	+/- (YoY)
Revenue	7,686	-6%	8%
Gross profit	1,387	-34%	6%
EBIT	1,242	-35%	51%
NPAT	866	-46%	53%

Sources: HPG, RongViet Research

Updates:

Hoa Phat's crude steel production capacity exceeded 2 million tons per year. HPG has been able to maintain a market share of over 20%, the highest among domestic steel makers, by selling both billets and rebar. The fact that HPG is operating 3 out of 4 BOF mills in Vietnam helps the company to stabilise its gross margin at a considerably higher level than other steel companies, implying a more competitive cost of production for Hoa Phat.

The steel business is expanding to different segments and activities. Currently running at full capacity of around 180,000 tons per month, HPG has now started to sell billets to rebar producers at a fairly competitive price compared to Chinese imported products, thanks to the similar production method. Recently, HPG has received orders from North American markets, whose demand can be sustainable as the countries have levied heavy countervailing duties on Chinese steel. HPG is now capable of supplying welding rods, which the domestic industry was incapable of producing due to insufficient methods, even though the market demand is only around 100,000 tons per year. It can clearly be observed that HPG has been expanding its influence by selling B2B, exporting, and tackling niche markets.

Coking coal prices have gone up by 300%, and iron ore by 74% since the beginning of the year, raising costs for most global steel firms. BOF's production cost is estimated to be 40% higher YoY solely due to the surge of coking coal prices. On the other hand, Electric arc furnace (EAF), another common production process, has also seen a rise in its costs, as steel scrap, the major input, is now 45% higher in price compared to last year. Considering the fact that most Vietnamese steel mills are equipped with EAFs, the domestic rebar price is going to face upward pressure in 2017, as the low-cost inventory is consumed during 2016.

Coking coal prices climbed due to China's policy which limits miners' production. With the aim of reforming the steel industry, China has put a cap on coal miners' operating days, inflating coking coal prices since April. However, the limit has been newly revised to the previous level, and the price of coking coal is consequently expected to return to the sustainable price of USD150 per ton, even though this adjustment may take time.

Since gross margin is considerably dependent on various input prices, RongViet Research has conducted a sensitivity analysis based on 3 scenarios to display the impact of the global coking coal price and the domestic rebar price on HPG's gross profit margin.

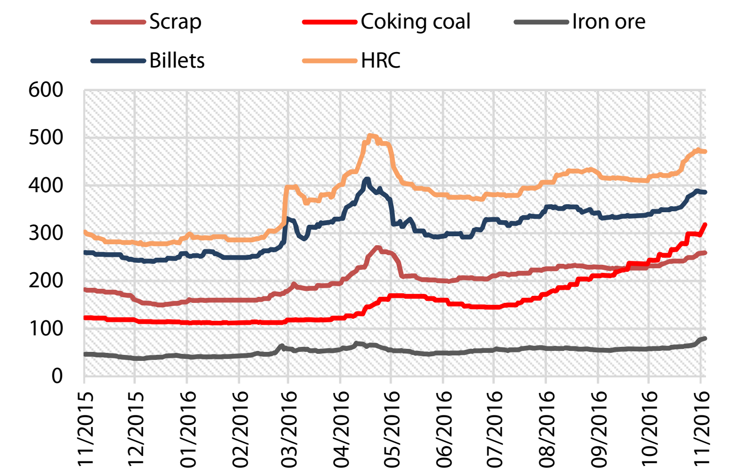
Table 4: HPG's Gross Margin Sensitivity Analysis

2017 gross margin		Domestic Rebar (VND per KG)		
		10,200	11,700	13,200
Global Coking Coal Price (USD per ton)	350	8.7%	15.5%	21.3%
	275	13.7%	20.1%	25.5%
	200	18.7%	24.7%	29.7%

Source: RongViet Research forecasts

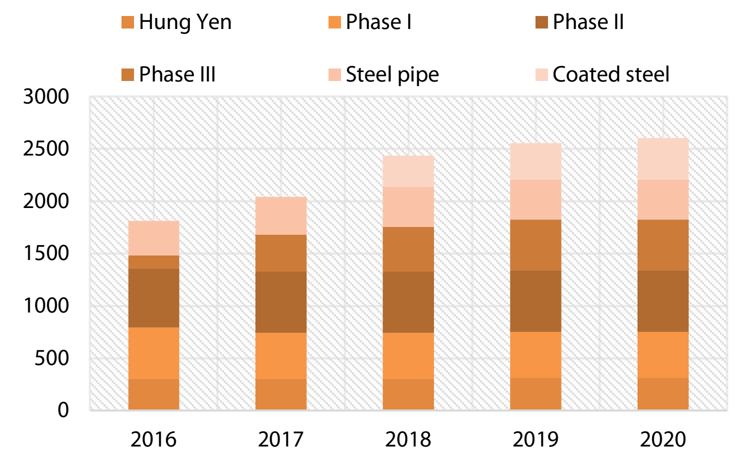
Under the most pessimistic scenario (VND10,200 per kg rebar price, USD350 per ton coking coal price), HPG's gross margin may plummet to below 10%, which we consider to be unlikely as the coking coal shortage has been eased due to the Chinese government revising the working day limit in mines this month. Moreover, we predict that Vietnamese steel makers, which have benefited enormously from the cheap stocks in 2016, will have to purchase inventory at recent prices, and are likely to increase their ASPs and pass the costs on to customers. In HPG's case, its remarkable gross margin of 26% in 9M2016 may not be maintained in 2017, but the company can keep the figure above 20%.

Input Prices (USD per ton)



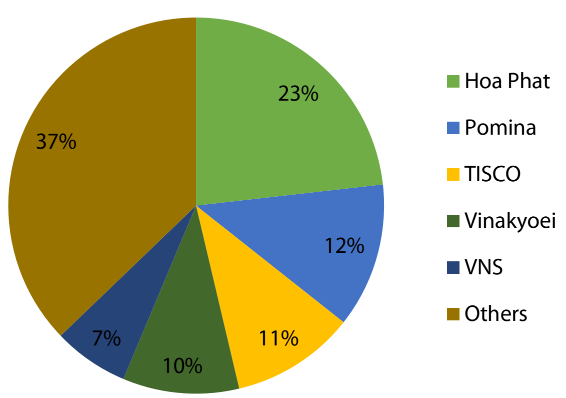
Sources: Bloomberg, RongViet Research

Steel Production Capacity by Segments



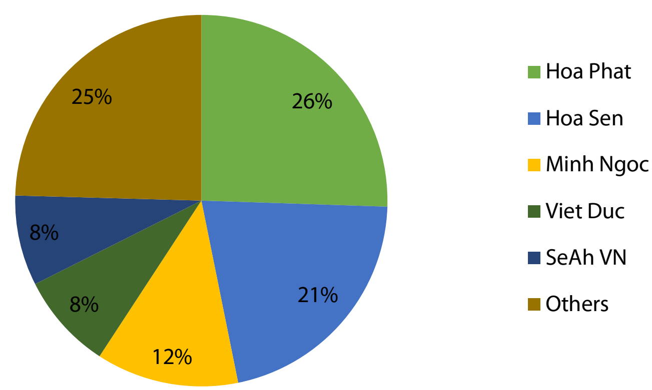
Sources: HPG, RongViet Research

Domestic Rebar Market Share 9M2016



Sources: HPG, VSA, RongViet Research

Domestic Steel Pipe Market Share 9M2016



Sources: HPG, VSA, RongViet Research

VND billion

INCOME STATEMENT	2014A	2015A	2016E	2017F
Revenue	25,525.3	27,452.7	31,018.7	39,369.5
COGS	20,338.3	21,872.0	23,512.3	31,234.6
Gross profit	**5,187.0**	**5,580.7**	**7,506.3**	**8,134.9**
Selling Expense	366.1	424.1	465.3	590.5
G&A Expense	607.2	758.8	682.4	866.1
Finance Income	160.3	253.9	293.6	373.9
Finance Expense	563.8	571.5	404.1	518.0
Other profits	-40.5	-90.3	52.7	65.2
PBT	**3,769.5**	**3,989.7**	**6,300.9**	**6,599.3**
Prov. of Tax	514.9	485.4	756.1	725.9
Minority's Interest	106.0	18.9	20.8	22.9
PAT to Equity Shareholder	**3,148.6**	**3,485.4**	**5,523.9**	**5,850.4**
EBIT	**4,120.1**	**4,241.1**	**6,623.8**	**6,858.3**
EBITDA	5,226.2	5,522.4	7,737.2	8,138.0

%

FINANCIAL RATIO	2014A	2015A	2016E	2017F
Growth				
Revenue	34.8	7.6	13.0	26.9
Operating Income	61.2	4.4	44.6	5.0
EBITDA	49.0	2.9	56.2	3.5
PAT	62.2	10.7	58.5	5.9
Total Assets	-4.3	15.9	16.4	20.7
Equity	24.2	22.6	36.6	23.2
Internal growth rate	16.0	18.2	24.9	20.8
Profitability				
Gross profit/Revenue	20.3	20.3	24.2	20.7
Operating profit/ Revenue	16.5	16.0	20.5	17.0
EBITDA/ Revenue	20.5	20.1	24.9	20.7
Net margin	12.3	12.7	17.8	14.9
ROAA	13.9	14.6	19.9	17.8
ROAE	29.6	26.5	32.3	26.5
Efficiency				
Receivable Turnover	15.2	16.5	15.2	13.1
Inventory Turnover	2.6	3.1	3.2	3.4
Payable Turnover	4.8	6.3	5.8	6.4
Liquidity				
Current	1.3	1.2	1.9	2.0
Solvency				
Total Debt/Equity	83.3	76.3	49.9	46.9
Current Debt/Equity	48.6	42.3	18.8	17.8
Long-term Debt/ Equity	7.9	5.1	7.0	3.8

VND billion

BALANCE SHEET	2014A	2015A	2016E	2017F
Cash and short-term investment	2,533	3,133	4,365	4,424
Receivables	1,720	1,608	2,481	3,543
Inventories	7,386	6,938	7,759	10,620
Other current assets	107	243	364	546
Total Current Asset	**11,746**	**11,922**	**14,970**	**19,133**
Fixed Assets	8,548	8,047	10,930	12,144
Construction in Progress	429	4,353	2,500	3,000
Long-term Investment	61	103	205	246
Other long-term assets	545	726	884	1,087
Long-term Asset	**10,343**	**13,676**	**14,821**	**16,810**
Total Asset	**22,089**	**25,597**	**29,791**	**35,943**
Payables	2,087	2,689	2,116	3,436
Current Debt	5,737	6,119	3,722	4,331
Long-term Debt	931	739	1,382	925
Other long-term liabilities	96	308	462	694
Total Liability	**9,829**	**11,042**	**9,860**	**11,416**
Owner's Equity	**11,796**	**14,467**	**19,762**	**24,342**
Capital	4,819	7,330	8,429	8,429
Retained Earnings	4,095	5,550	9,699	14,168
Funds & Reverses	675	914	961	1,072
Others	**0**	**0**	**0**	**0**
Total Equity	**11,796**	**14,467**	**19,762**	**24,342**
Minority's Interest	169	0	169	186
TOTAL RESOURCES	**21,795**	**25,509**	**29,791**	**35,943**

VALUATION RATIO	2014A	2015A	2016E	2017F
EPS (dong)	5,114	4,056	6,554	6,942
P/E (x)	6.53	8.83	6.41	6.05
BV (dong)	24,478	19,738	23,446	28,879
P/B (x)	1.72	2.13	2.13	1.45
DPS (dong/cp)	3,000	1,500	1,500	1,500
Dividend yield (%)	7.14	3.57	3.57	3.57

VALUATION MODEL	*Price*	*Weight*	*Average*
FCFE	50,197	50%	25,099
P/E	50,469	50%	25,234
Target price (dong/share)			**50,300**

VALUATION HISTORY	*Price*	*Recommendation*	*Period*
15/01/2016	33.200	Buy	Long term

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Intermediate- term (up to 6 months)	>20%	10% to 20%	-5% to10%	-15% to- 5%	<-15%
Long-term (over 6 months)	>30%	15% to 30%	-10% to 15%	-15% to -10%	<-15%

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Network

Headquarter

Address: Floor 1-2-3-4-5, Viet Dragon Tower, 141 Nguyen Du, Ben Thanh Ward, Dist.1, Tp.HCM

Phone: 84.8 6299 2006   Fax: 84.8 6291 7986

Website: www.vdsc.com.vn

Ha Noi Branch

2C Thai Phien – Hai Ba Trung District – Ha Noi

Nha Trang Branch

50Bis Yersin - Nha Trang

Can Tho Branch

08 Phan Dinh Phung –Cần Thơ

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