August, 2018

PETROVIETNAM POWER NHON TRACH 2 JSC (HSX:NT2)

Rising gas prices erodes core earnings

(VND B)	Q2-FY18	Q1-FY18	*+/-qoq*	Q2-FY17	*+/-yoy*
Net revenue	2,008	2,021	-1%	1,781	13%
PAT	269	235	14%	190	41%
EBIT	227	342	-34%	378	-40%
EBIT margin (%)	11.3	16.9	-560bps	21.2	-990bps

Source: NT2, RongViet Securities

1H2018 Performance: Favorable EUR/VND exchange rate movement kept earnings growth amid rising gas prices

In the first half of 2018, NT2 had contract volume (Qc) of 2.18 billion kWh (-7% YoY), while average gas prices rose by 21% to 6.7 USD/million BTU. As a result, although both sales volume and average selling price increased by 13% YoY and 1% YoY, respectively, NT2's gross profit still fell by 21% YoY to VND 624 billion.

The EUR depreciated by 1% against the VND in the first six months of the year, contributing to a net FX gain of VND 16.5 billion.

Rising gas prices and lower Qc weaken NT2's long-term prospect

From 2018, the contract volume (Qc) of NT2 was reduced by 5.5% to 4,025 million. As PPA contracts of power plants were designed with a certain amount of Qc to ensure stable profit level for the plants against volatility in input prices, lower Qc also means higher risk. In addition, since the average gas price of NT2 in the first half of 2018 has increased by 21% YoY and almost doubled from 2016, we believe that gas input price is a significant risk for NT2.

In the longer term, a reduction in gas supply from old gas fields in Nam Con Son basin could be compensated by new gas fields coming into operation in 2019 – 2022. However, the gas prices of these new fields are expected to be much higher than that of the old gas fields. Therefore, we expect a rising trend in input gas prices for NT2 in the next five years, resulting in further decline in its earnings and lower cash dividend in 2019 – 2021.

Valuation and Recommendation:

*We estimate that 2018 NPAT will decrease by 9% YoY to VND 736 billion, corresponding to EPS of 2,467 VND/share. Although the above analysis shows a lower earnings base and lower expected cash dividend in the coming years for NT2, we also notice that the fall in 1H 2018 has fully reflected these unfavorable movements. Our target price is **VND 27,100 per share**. This target price, coupled with a VND 2,500 cash dividend in the next 12 months, yields a total return of 11% (calculated based on the closing price on 23 August). Therefore, we have a **ACCUMULATE** recommendation on NT2.*

ACCUMULATE +11%

CMP (VND)	26,650
Target price (VND)	27,100
Cash dividend (VND)*	2,500

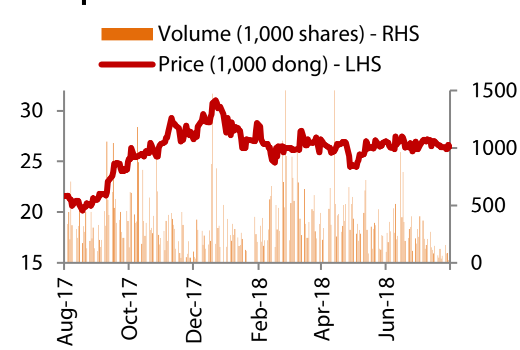
** Expected in the next 12 months*

Stock info

Sector	Utilities
Market Cap (VND billion)	7,614
Current Shares O/S	287,876,029
Avg. Daily Volume (in 20 sessions)	144,613
Free float (%)	20
52 weeks High	31,036
52 weeks Low	20,150
Beta	0.8

	FY2017	Current
EPS	2,716	2,875
EPS growth (%)	-9.2	16.6
Adjusted EPS	3,661	3,162
P/E	12.1	9.1
P/B	2.0	2.1
EV/EBITDA	6.2	6.0
Cash dividend	3,000	4,792
ROE (%)	16.3	23.4

Price performance



Major Shareholders (%)

PV Power	59.37
CFTD Ltd.	8.27
Foreign ownership room (%)	27.91

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Exhibit 1: Q2 2018 results

Particulars (VND Bn)	Q2-FY18	Q1-FY18	+/-(QoQ)	Q2-FY17	+/-(YoY)	2Q-FY18	+/-(YoY)
Net revenue	2,008	2,021	-1%	1,781	13%	4,030	14%
Gross profit	261	363	-28%	401	-35%	624	-21%
SG&A	-34	-21	59%	-23	45%	-55	3%
Operating income	283	247	15%	200	42%	530	11%
EBITDA	400	513	-22%	551	-27%	913	-16%
EBIT	227	342	-34%	378	-40%	570	-23%
Financial expenses	-46	-112	-59%	-193	-76%	-158	-46%
- Interest Expenses	-25	-26	-2%	-29	-13%	-51	-21%
Dep. and amortization	173	171	1%	173	0%	343	0%
Non-recurring items (*)	83	-67		-144		17	
Extraordinary items (*)							
PBT	283	248	14%	200	41%	530	10%
PAT	269	235	14%	190	41%	504	10%
(*) Adjusted PAT	185	302	-39%	334	-45%	487	-24%

Source: NT2, RongViet Securities

Exhibit 2: Q2 2018 performance analysis

Particulars	Q2-FY18	Q1-FY18	+/-(QoQ)	Q2-FY17	+/-(YoY)
Profitability ratios (%)					
Gross margin	13.0	18.0	-497bps	22.5	-952bps
EBITDA margin	19.9	25.4	-546bps	30.9	-1,100bps
EBIT margin	11.3	16.9	-560bps	21.2	-990bps
Net margin	13.4	11.6	175bps	10.7	271bps
Adjusted net margin	9.2	14.9	-572bps	18.8	-953bps
Turnover *(x)					
-Inventories	27.1	25.7	1.4	22.0	5.1
-Receivables	3.2	3.7	-0.6	3.2	0.0
-Payables	2.9	4.4	-1.6	3.4	-0.5
Leverage (%)					
Total debt/ equity	173	108	6,515bps	107	6,640bps

Source: NT2, (*) Annualized turnover

Exhibit 3: Q3 2018 performance forecast

Particulars (VND B)	Q3-FY18	+/-(QoQ)	+/-(YoY)
Revenue	1,590	-21%	40%
Gross profit	191	-27%	19%
EBIT	167	-27%	17%
NPAT	79	-71%	130%

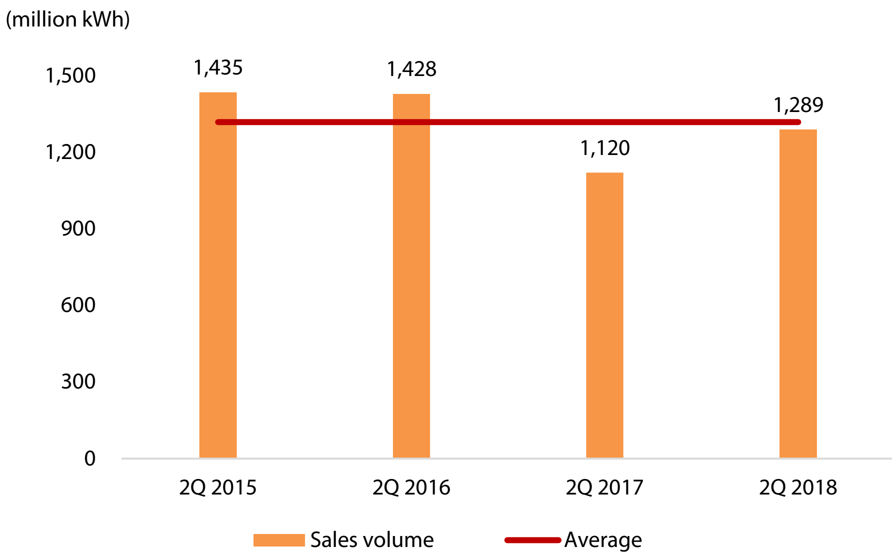
Source: NT2, RongViet Securities.

Updates

Technical issues of the compressor had minor impact on NT2's operation In 2Q 2018

The compressor of Lan Tay rig, which belongs to block 06.1, experienced a technical problem late-March to early-June this year, reducing 10% of total gas supply for the Southeast region during this period. However, when the gas supply was limited in dry season, power plant with the highest operation efficiency such as NT2 had higher priority and thus was less affected by the issue. In particular, total output of NT2 in 2Q 2018 was about 1.3 billion kWh (+15% YoY). We consider this output comparable to NT2's average output in the second quarter of the recent four years.

Figure 1. NT2's electricity output in the second quarter of 2015 - 2018



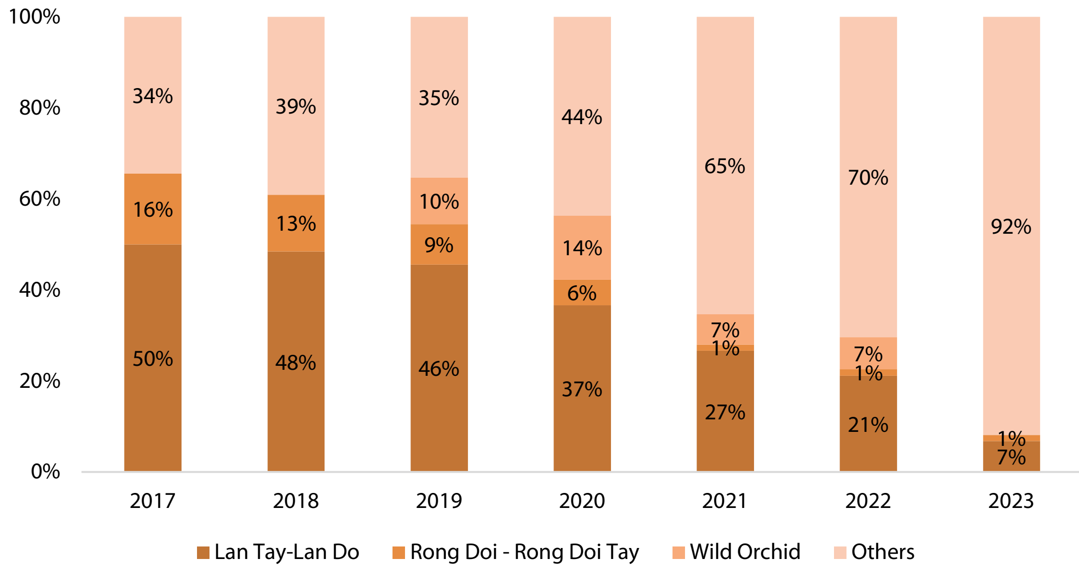
Source: NT2, RongViet Securities

The problem lies not in gas supply but in gas prices and in contract volume (Qc)

There will be adequate gas supply for NT2 in the coming years. Although the supply from gas fields Nam Con Son basin such as Lan Tay – Lan Do, Rong Doi – Rong Doi Tay is expected to decline gradually from 3.9 bcm p.a in 2019 to 0.6 bcm p.a in 2023, the new gas fields such as Wild Orchid, Sao Vang – Dai Nguyet, White Lion would compensate for this reduction. In particular, the Wild Orchid gas field is expected to provide about 0.5 – 1.0 bcm of gas p.a from 2019 to 2022, while the supply from Sao Vang – Dai Nguyet and White Lion gas fields would increase gradually from 0.5 bcm p.a in 2020 to 3.2 bcm p.a in 2023. In addition, the LNG Thi Vai project when coming into operation in 2023 would also contribute about 1.5 bcm of gas p.a to the Southeast region. Therefore, we expect that total gas supply in the region would be adequate for thermal power plants there.

As oil prices were on uptrend over the last 12 months and expected to stay at current level in the long-term, the gas price for NT2 is now a significant problem. Moreover, although we expect adequate total amount of gas supply for the plants, we also see a decrease in the proportion of gas supply from sources that have relatively lower prices.

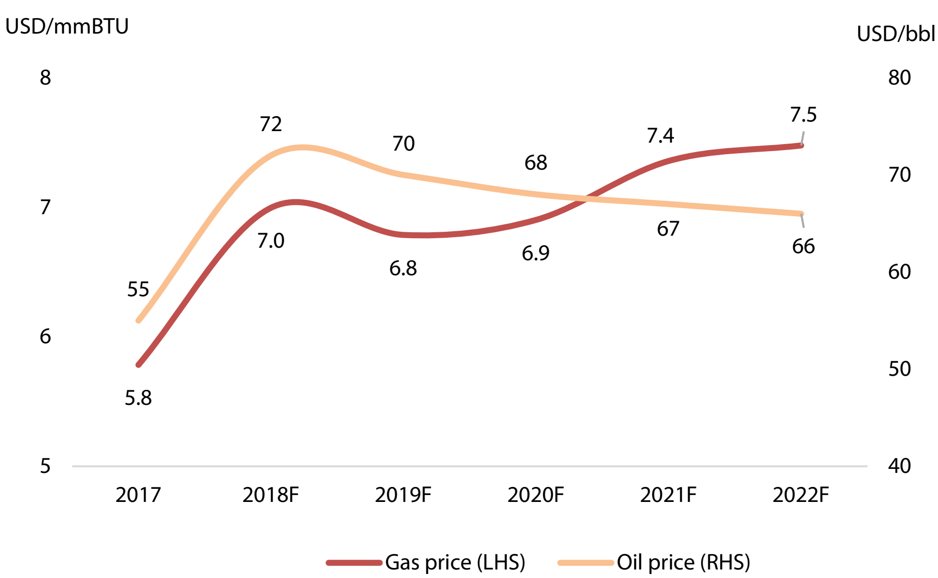
Figure 2. The proportion of some gas fields in total gas supply of the Southeast region



Source: GAS, RongViet Securities

Lan Tay, Lan Do gas fields (block 6.1) and Rong Doi – Rong Doi Tay gas fields (block 11.2) have relatively lower gas prices than the average gas price in the region. However, as their weight in total gas supply would start to decrease from 2020, we expect that the average gas price for power plants in the Southeast region, including NT2, would increase as a result.

Figure 3. Oil price and NT2's gas prices during 2017 – 2022F



Source: NT2, RongViet Securities forecasts

Lower Qc makes earnings more sensitive to gas prices. So far in 2018, for thermal power plants, the ratio of contract volume (Qc) to expected mobilized volume (AGO) decreased from 90% to 85%. As a result, the Qc of NT2 is 4,025 million kWh (-5.5% YoY). Lower Qc means higher exposure to the competitive generation market (CGM), where selling prices depend on hourly offers and the supply-demand situation of power systems. In addition, power plants on CGM have to compete with one another through variable costs. As a result, changes in gas prices would also affect NT2's competitiveness on CGM as well as its income from CGM.

Figure 4. Sensitivity analysis on the impact of gas prices on NT2's 2018 business results

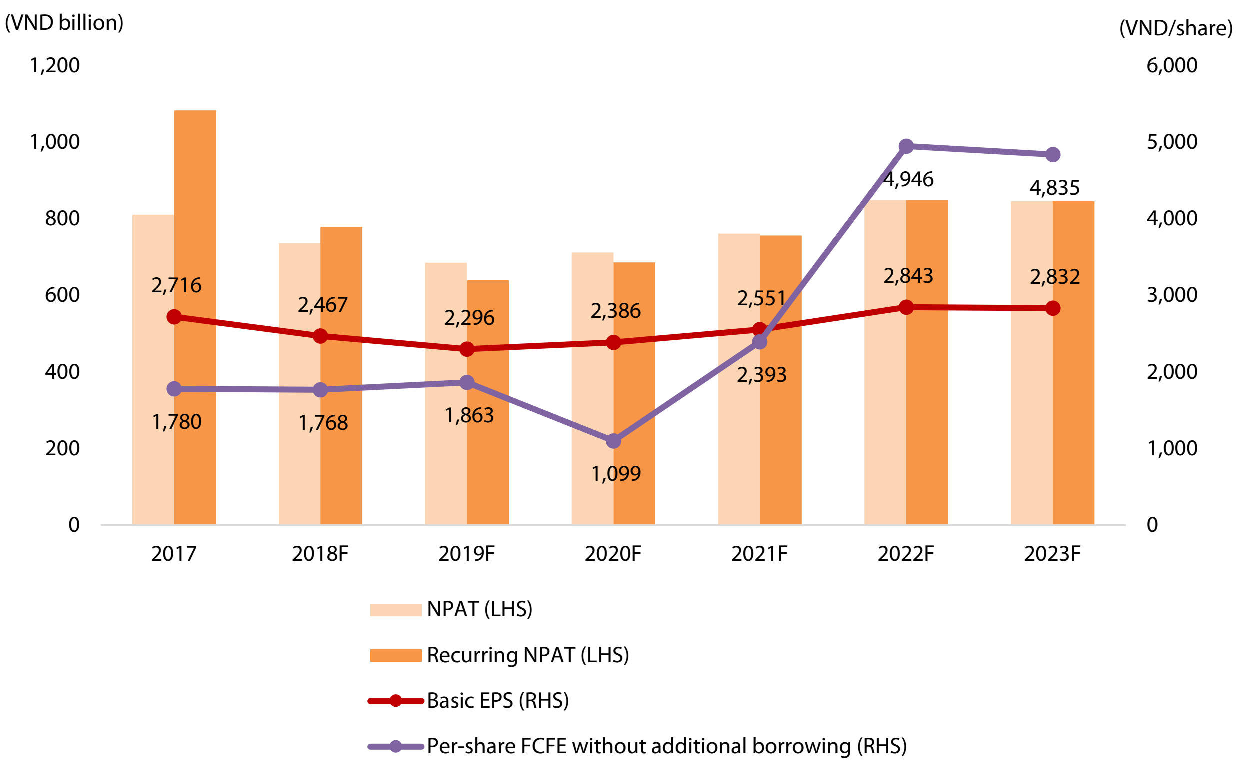
	Unit	Gas price scenario					Note
Average gas price	USD/mm BTU	6.60	6.80	**7.00**	7.20	7.40	• Oil price in 2H 2018 in our base-case scenario is 74 USD/bbl, corresponding to 2018 average gas price of 7.0 USD/mm BTU
Sales volume	million kWh	4,787	4,787	4,787	4,787	4,787	• We keep volume and CGM prices constant in our analysis
Contract volume	million kWh	4,025	4,025	4,025	4,025	4,025	
Pc	VND/kWh	1,595	1,628	1,661	1,694	1,727	
Revenue	VND Bn	**7,453**	**7,588**	**7,720**	**7,858**	**7,992**	
COGS	VND Bn	6,316	6,470	6,621	6,778	6,932	
Gross profit	VND Bn	1,137	1,118	1,099	1,079	1,060	• Volume exposed to CGM (Qm) is not hedged by PPA contract, which leads to volatility in gross profit when gas prices change
Gross profit margin	%	15.3	14.7	14.2	13.7	13.3	
NPAT	VND Bn	**778**	**757**	**736**	**714**	**692**	• We forecast VND depreciation against USD and EUR to be 3% and 2%, respectively, corresponding to net FX loss of VND 45 billion
Recurring NPAT	VND Bn	**821**	**800**	**779**	**757**	**735**	• On average, 1% change in gas prices would result in 0.5% change on recurring NPAT
EPS	VND/share	2,609	2,537	2,467	2,393	2,321	

Source: RongViet Securities estimates

Lower earnings base raised questions on the dividend policy of NT2 in the coming years

In the first eight months of 2018, NT2 has paid total a cash dividend of 4,792 VND/share. As the company plans to pay a cash dividend for FY2018 at 1,500 VND/share, we estimate that it would take NT2 over VND 1,800 billion to pay for it this year. However, we also estimate that total free cash flow to equity (FCFE) generated during 2018 is only VND 680 billion. Therefore, our projection is that NT2, after using up most of its cash and short-term investment, may need short-term debt to pay such a dividend.

Figure 5. NT2's per-share FCFE compared to its per-share earnings



Source: NT2, RongViet Securities forecasts

Although the company has enough retained earnings to maintain the cash dividend of 2,500 VND/share in the long-term, the aggressive debt repayment schedule until 2021 would leave it with inadequate cash to maintain this dividend level. In addition, the above analyses leads us to believe that, unless NT2 uses short-term debt to maintain the current dividend level of about 2,500 VND/share, its annual cash dividend in 2019 – 2021 may have to be reduced to 1,000 - 1,500 VND/share, which we consider disappointing compared to market expectations.

Valuation and Recommendation:

Being the most efficient gas fired power plant in Vietnam, NT2 is still affected by the upward trend of gas price and the reduction of Qc, an inevitable trend resulted from the liberalization of Vietnam power market. Even though we expect more positive long-term impacts of the market liberalization on NT2's business results, we also believe that these impacts are still too uncertain to quantify and too early to factor now in earnings forecasts of the company. Regarding 2018 outlook, we estimate that 2018 NPAT would decrease by 9% YoY to VND 736 billion, corresponding to EPS of 2,467 VND/share.

Although the above analyses show a lower earnings base and lower expected cash dividend in the coming years for NT2, we also notice that the fall in 1H 2018 has fully reflected these unfavorable movements to NT2's stock price. Our target price is VND 26,800 per share. This target price, coupled with a VND2,500 cash dividend in the next 12 months, yields a total return of 11% (calculated based on the closing price on 23 August). Therefore, we have a ***ACCUMULATE*** *recommendation on NT2.*

VND in billions

Income statement	FY2016	FY2017	FY2018E	FY2019F
Revenue	7,983	6,761	7,720	7,883
COGS	6,632	5,368	6,628	6,844
Gross profit	**1,351**	**1,393**	**1,092**	**1,039**
Selling expense	0	0	0	0
G&A expense	57	114	115	119
Finance income	103	63	27	6
Finance expense	249	490	230	204
Other profits	-1	1	0	0
Gain/(loss) from JVs	0	0	0	0
PBT	**1,148**	**853**	**775**	**721**
Prov. of tax	63	43	39	36
Minority's interest	0	0	0	0
PAT to equity S/H	**1,086**	**810**	**736**	**685**
EBIT	1,295	1,279	977	920
EBITDA	1,989	1,971	1,691	1,639

%

Financial ratio	FY2016	FY2017	FY2018E	FY2019F
Growth (%)				
Revenue	18.6	-15.3	14.2	2.1
Operating income	-13.4	-1.2	-23.6	-5.9
EBITDA	-9.1	-0.9	-14.2	-3.1
PAT	-4.9	-25.3	-9.2	-6.9
Total assets	11.5	-23.2	-10.3	-10.6
Equity	2.9	1.6	-18.7	9.8
Profitability (%)				
Gross margin	16.9	20.6	14.1	13.2
EBITDA margin	16.2	18.9	12.7	11.7
EBIT margin	24.9	29.2	21.9	20.8
Net margin	13.6	12.0	9.5	8.7
ROA	8.4	8.1	8.2	8.6
ROE	22.1	16.3	18.2	15.4
Efficiency (x)				
Receivable turnover	0.3	0.4	0.3	0.3
Inventory turnover	0.0	0.0	0.0	0.0
Payable turnover	0.3	0.4	0.2	0.3
Liquidity (x)				
Current	1.2	1.4	0.9	0.8
Solvency (%)				
Total debt/equity	1.0	0.7	0.7	0.4
Current debt/equity	0.2	0.2	0.3	0.3
Long-term Debt/equity	0.8	0.5	0.4	0.1

VND in billions

Balance sheet	FY2016	FY2017	FY2018E	FY2019F
Cash and cash equivalents	1,398	146	85	157
Short-term investments	0	900	0	0
Accounts receivable	3,610	1,795	2,320	1,971
Inventories	239	259	313	323
Other current assets	69	0	0	0
Property, plant & equipment	6,908	6,225	5,618	4,981
Acquired intangible assets	28	26	21	16
Long-term investments	0	0	0	0
Other non-current assets	728	612	576	540
Total assets	**12,980**	**9,964**	**8,933**	**7,988**
Accounts payable	3,242	1,203	1,925	1,711
Short-term borrowings	1,045	1,066	1,238	1,215
Long-term borrowings	3,697	2,632	1,637	533
Other non-current liabilities	24	23	23	23
Bonus and welfare fund	23	15	17	19
Technology-science, dev. fund	41	40	40	40
Total liabilities	**8,071**	**4,979**	**4,881**	**3,541**
Common stock and APIC	2,878	2,878	2,878	2,878
Treasury stock (enter as -)	0	0	0	0
Retained earnings	1,970	1,036	1,431	1,853
Other comprehensive income	0	0	0	0
Inv. and dev. fund	137	137	137	137
Total equity	**4,985**	**4,052**	**4,447**	**4,869**
Minority interest	**0**	**0**	**0**	**0**

Valuation ratio	FY2016	FY2017	FY2018E	FY2019E
EPS (VND)	3,701	2,716	2,467	2,296
P/E (x)	6.6	7.2	10.8	11.6
BV (VND)	17,230	17,317	14,074	15,447
P/B (x)	1.5	1.6	2.0	1.9
DPS (VND/cp)	2,878	3,123	5,792	1,000
Dividend yield (%)	10.8	11.4	21.4	3.7

Valuation model	Price	Weight	Average
FCFF	30,792	40%	12,317
PE	22,200	30%	6,660
EV/EBITDA	27,153	30%	8,146
Target price (VND)			**27,100**

Valuation history	Price	Recommendation	Period
10/02/2018	37,600	Accumulate	Long term
15/03/2017	31,900	Accumulate	Long term
15/05/2016	35,600	Accumulate	Long term

RESULTS UPDATE

This report is created for the purpose of providing investors with an insight into the discussed company that may assist them in the decision-making process. The report comprises analyses and projections that are based on the most up-to-date information with the objective that is to determine the reasonable value of the stock at the time such analyses are performed. Through this report, we strive to convey the complete assessment and opinions of the analyst relevant to the discussed company. To send us feedbacks and/or receive more information, investors may contact the assigned analyst or our client support department.

RATING GUIDANCE

Ratings	BUY	NEUTRAL	SELL
Total Return including Dividends in 12-month horizon	>20%	-20% to 20%	<-20%

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