Da Nang Rubber JSC (HSX:DRC)

Getting Through Difficult Times

Particular (VND B)	Q3 FY17	Q2 FY17	*+/- qoq*	Q3 FY16	*+/- yoy*
Net revenue	877.9	863.6	1.7%	794.9	10.4%
PAT	25.3	34.7	-27.0%	83.2	-69.6%
EBIT	41.7	55.0	-24.3%	114.5	-63.6%
EBIT margin	4.7%	6.4%	-1.6 pps	14.4%	-9.7 pps

Source: DRC, RongViet Research

Q3 2017 performance. In the third quarter of this year, DRC's revenue reached VND877.9 billion, up 10.4% compared to the same period of last year. Notwithstanding that, DRC's net profit after tax (NPAT) was only VND25.3 billion, decreasing by 69.6% YoY. As a result, DRC fulfilled 72.6% of its sales target, but only 24.2% of goal profit after the first nine months of 2017. One of main reasons was the surge of natural rubber price at the beginning of year. Even though the rubber price was at VND37 - 38 million per tonne in Q3, DRC's gross profit margin just recorded 11.2% because the company has been stockpiling materials at high prices (approximately VND50 million per tonne) in the first half of year. In addition, the explanation for the increase of selling expenses in the third quarter (higher by VND15.8 billion compared with the same quarter of prior year) is the rise of the marketing cost and the higher export costs which were in line with the increase of export quarter revenue to VND12.1 million (+ 36.8% YoY).

Q4 2017 and 2018 potential. In Q4 FY2017, DRC has given a sales goal of VND1,000 billion, but the target profit is more "cautious" when the profit before tax was set only at VND23 billion. However, the rubber price is being traded at a stable low price range. We estimate that DRC's profit margin in the fourth quarter would recover significantly to 18.5%, and PBT would reach VND150 billion.

Looking at the outlook for 2018, we realize a positive signal from the radial tire products as the company will put some production lines of the second phase in the first quarter and second quarter to meet the export orders. Currently, we estimate that the capacity of the first phase would exceed 100% within this year; and the output of radial tires in 2017 and 2018 will be 326,200 and 358,900 units, respectively. DRC's revenue in 2018 is estimated at VND 3,784 billion (+ 4.1% YoY). As rubber price is forecasted to keep fluctuating around the current price range due to abundant supply, we estimate that DRC's GPM would be 16.2%; EBT would be VND379 billion (+ 40.3 % YoY), equivalent to EPS of VND2,349 per share.

Valuation and Recommendation: *DRC stock has depreciated owing to the poor performance of the business in the last two quarters. However, with sales maintaining steady growth, in which radial tires are the main driver, and rubber prices forecasted to stabilize at low price range, we hold the view that the performance of DRC would flourish from Q4 2017. Based on two valuation methods, DCF and PE, with adjustment to the estimation closer to DRC's actual business results compared to the Company updates on July 14, 2017, we rate NEUTRAL on this stock with the target price of VND28,200 per share. It is also worth noting that the ability of Vinachem's divestment from DRC could be a key diver for the upside potential. This could be similar to the upward trend of price of other companies having similar divestment stories.*

NEUTRAL

CMP (VND)	23,800
Target Price (VND)	28,200
Cash Dividend (VND)*	1,800

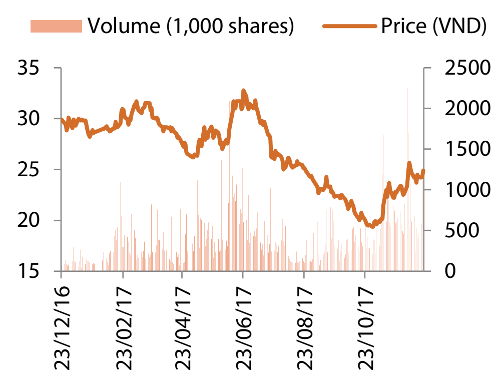
** Expected in the next 12 months*

Stock Info

Sector	Automobile and Parts
Market Cap (VND B)	2,827
Current Shares O/S	118,792,605
Beta	0.9
Free float (%)	33
52 week High	32,778
52 week Low	19,373
Avg. Daily Volume (20 sessions)	755,482

	FY2016	Current
EPS	3,327	2,054
P/E	9.6	12.12
P/B	2.4	1.9
EV/EBITDA	5.9	6.3
Cash dividend	2,800	500
ROE (%)	24.3	15.4

Price performance



Major Shareholders (%)

Vinachem	50.51
Foreign ownership room (%)	24.04

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Exhibit 1: Q3 2017 results

Particulars (VND bn)	Q3 2017	Q2 2017	+/- (QoQ)	Q3 2016	+/- (yoy)	9M 2017	+/- (YoY)
Net revenue	877.9	863.6	1.7%	794.9	10.4%	2,641.7	8.8%
Gross profit	98.2	111.9	-12.3%	150.7	-34.9%	342.2	-32.4%
SG&A	50.5	49.9	1.3%	31.3	61.3%	129.5	12.3%
Operating income	47.7	62.0	-23.2%	119.4	-60.1%	212.6	-53.3%
EBITDA	271.5	198.5	36.8%	319.5	-15.0%	638.6	-18.4%
EBIT	41.7	55.0	-24.3%	114.5	-63.6%	195.6	-49.1%
Financial expenses	17.4	20.2	-13.9%	17.8	-2.1%	55.7	-0.6%
- Interest Expenses	10.0	11.6	-13.7%	10.5	-4.6%	32.2	-0.2%
Dep. and amortization	229.8	143.5	60.2%	205.0	12.1%	443.0	11.3%
Non-recurring items (*)							
Extraordinary items (*)							
PBT	31.7	43.4	-27.1%	104.0	-69.6%	163.5	-53.7%
PAT	25.3	34.7	-27.0%	83.2	-69.6%	130.6	-53.6%
(*) Adjusted PAT	25.3	34.7	-27.0%	83.2	-69.6%	130.6	-53.6%

Source: DRC, RongViet Research

Exhibit 2: Q3 2017 performance analysis

Particulars	Q3 2017	Q2 2017	+/- (QoQ)	Q3 2016	+/- (YoY)
Profitability ratios (%)					
Gross margin	11.2%	13.0%	-1.8%	19.0%	-7.8%
Ebitda margin	4.7%	6.4%	-1.6%	14.4%	-9.7%
Ebit margin	4.7%	6.4%	-1.6%	14.4%	-9.7%
Net margin	2.9%	4.0%	-1.1%	10.5%	-7.6%
Adjusted net margin	2.9%	4.0%	-1.1%	10.5%	-7.6%
Turnover *(x)					
-Inventories	3.5	3.2	0.3	3.1	0.4
-Receivables	9.8	8.6	116 pps	10.0	-25 pps
-Payables	8.3	8.8	-43 pps	4.7	367 pps
Leverage (%)					
Total debt/ equity	0.6	0.8	-25 pps	0.5	3 pps

Source: DRC, (*) Annualized turnover

Exhibit 3: Q3 2017 performance forecast

Particulars (VND B)	Q3 2017	+/- QoQ	+/- YoY
Revenue	993	13.1%	6.8%
Gross profit	184	87.0%	-4.5%
EBIT	158	279.3%	3.9%
NPAT	85	236.0%	-24.9%

Source: DRC, RongViet Research

Updates:

Updates on the radial tire factory

The current production capacity of radial tires has reached around 28,000 - 29,000 units per month since Q3 2017. As planned, some lines of the second phase plant will be put into production in Q1 and Q2 of next year to meet the export orders, before officially operating at the end of Q4 2018 and doubling the total capacity of whole factory to 600,000 tires per year.

According to the sales results of the first nine months, DRC's radial tire sales have increased significantly this year, and 245,877 units were consumed (+ 50.3% YoY), equivalent to the revenue of VND923.5 billion (+50.1% YoY). Sixty-eight percent of sales was from exporting, approximately 167,445 units (+68.8% YoY). The radial tire exported revenue reached USD23.9 million and gradually occupied a larger share in the export revenue structure at 67.7%.

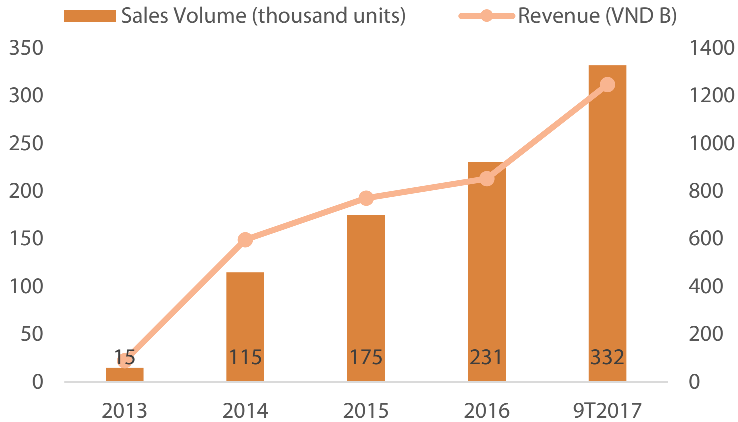
Based on the current sales outlook as well as the improvement in product quality through the completed project cooperated with Black Donuts in October 2017, we forecast that radial tire sales volume would reach 326,240 units in 2017 (exceeding 8.7% of the first phase's designed capacity) and 358,864 units in 2018.

Rubber price has turned around, decreasing after having peaked at the end of January 2017

As natural rubber accounts for 45–55% of COGS, the surge in raw material price has been one of the main reasons for lower results of DRC in first three quarters of 2017. Since the end of 2016, the rubber price has shown signs of reverse trend after years of downturn due to heavy rain and flood in the major growing region of southern Thailand, where around 80 percent of Thailand total natural rubber supply is being produced. This made supply drop and sent the price of SMR10 (a type of rubber DRC mainly uses) soaring from USD1.2 - 1.5/kg to the peak of USD2.28/kg in the middle of February 2017. However, this upward trend had just remained for a while before the average price decreased 37.3% from the peak in December. According to the *Commodity Market Outlook* of Word Bank, the rubber supply has improved across East Asia, especially in Malaysia, where production grew by more than 20 percent in the first half of 2017. Production jumped in Thailand as well, aided by improved weather conditions. Moreover, rubber trees can be tapped after a 7-year cultivation so there would a huge supply from new rubber tree plantations in 2005–2013. Therefore, we hold a view that price increase in 2018 and 2019 will be small and will remain at the low rate range of USD 1.3 - 1.4/kg.

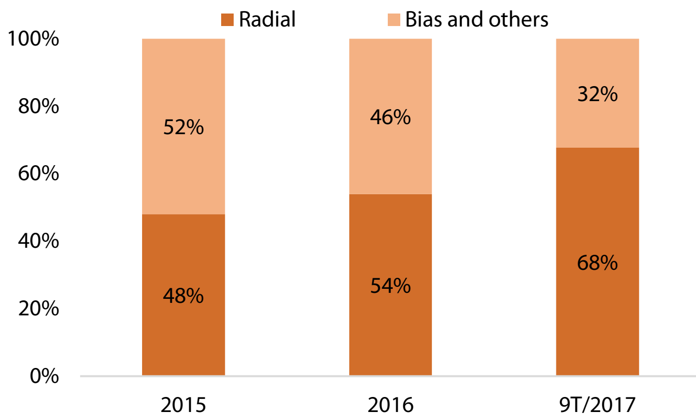
Appendix:

Figure 1: Revenue and sales volume of DRC's radial tires



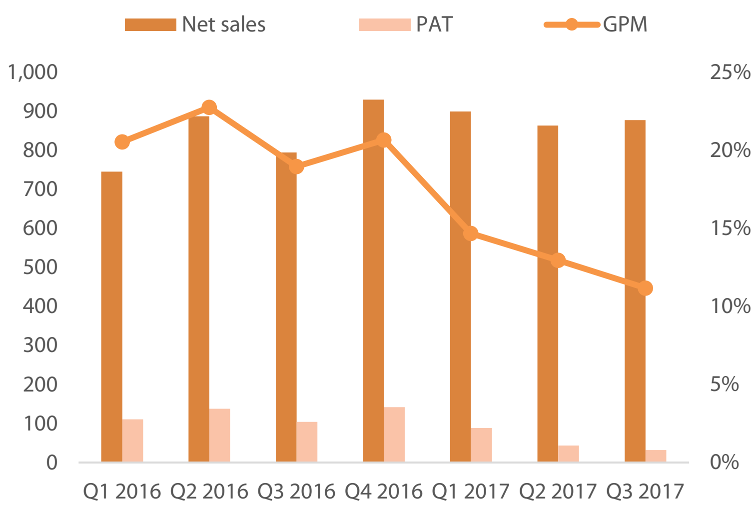
Source: DRC, RongViet Research

Figure 2: DRC's exporting revenue structure by product



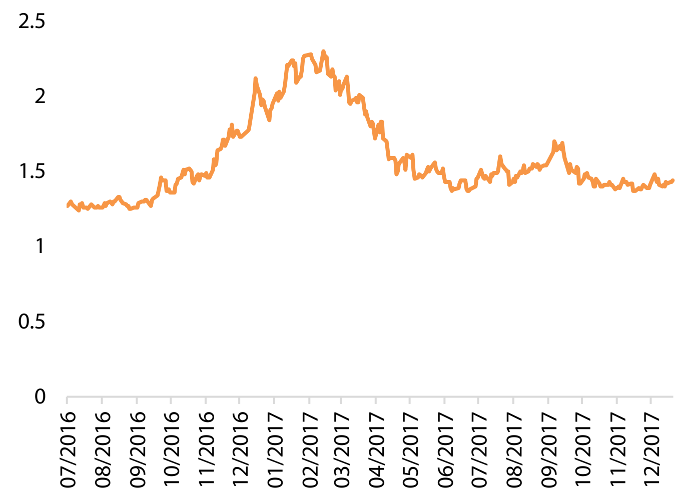
Source: DRC, RongViet Research

Figure 3: Quarterly business results of DRC



Source: DRC, RongViet Research

Figure 4: Chart of natural rubber (SMR10) price



Source: Bloomberg

VND billion

INCOME STATEMENT	FY2015	FY2016	FY2017E	FY2018F
Revenue	3,318	3,361	3,634	3,784
Cogs	2,518	2,660	3,109	3,169
Gross profit	800	701	526	614
Selling expense	77	85	124	104
G&a expense	84	73	62	64
Finance income	11	16	7	9
Finance expense	124	83	80	83
Other profits	7	18	3	8
Pbt	533	494	270	379
Prov. Of tax	117	99	54	76
Minority's interest	0	0	0	0
Pat to equity s/h	416	395	216	304
Ebit	639	543	340	446
Ebitda	848	775	546	635

%

FINANCIAL RATIO	FY2015	FY2016	FY2017E	FY2018F
Growth				
Revenue	2.1	1.3	8.1	4.1
Operating income	28.3	-8.6	-29.5	16.2
Ebitda	11.3	-15.1	-37.3	30.9
Pat	17.8	-5.0	-45.2	40.3
Total assets	0.2	-10.4	0.7	-0.2
Equity	8.9	-5.4	-0.9	2.6
Profitability				
Gross margin	24.1	20.9	14.5	16.2
Ebitda margin	25.6	23.1	15.0	16.8
Ebit margin	19.3	16.1	9.4	11.8
Net margin	12.5	11.8	6.0	8.0
ROA	13.2	14.0	7.6	10.7
ROE	24.9	25.0	13.8	18.9
Efficiency				
Receivable turnover	11.9	8.0	11.4	11.1
Inventory turnover	3.2	3.5	4.2	4.2
Payable turnover	6.0	8.5	11.1	11.1
Liquidity				
Current	1.5	1.5	1.3	1.5
Solvency	0.6	0.6	0.4	0.5
Total debt/equity				
Current debt/equity	62.1	57.2	62.1	57.1
Long-term debt/equity	26.6	32.5	37.1	32.9

VND billion

BALANCE SHEET	FY2015	FY2016	FY2017E	FY2018F
Cash and cash equivalents	240	51	22	90
Short-term investments	0	0	0	0
Accounts receivable	278	419	320	341
Inventories	785	771	746	761
Other current assets	0	6	7	7
Property, plant & equipment	1,818	1,499	1,669	1,556
Acquired intangible assets	1	6	5	5
Long-term investments	5	4	4	4
Other non-current assets	16	59	62	65
Total assets	**3,143**	**2,815**	**2,836**	**2,829**
Accounts payable	420	312	280	285
Short-term borrowings	446	513	582	530
Long-term borrowings	593	392	392	390
Other non-current liabilities	0	0	0	0
Bonus and welfare fund	11	16	16	16
Technology-science, dev. Fund	0	0	0	0
Total liabilities	**1,470**	**1,233**	**1,269**	**1,221**
Common stock and apic	917	1,188	1,188	1,188
Treasury stock (enter as -)	0	0	0	0
Retained earnings	461	225	195	215
Other comprehensive income	62	21	21	21
Inv. And dev. Fund	233	149	164	185
Total equity	**1,673**	**1,582**	**1,567**	**1,609**
Minority interest	**0**	**0**	**0**	**0**

VALUATION RATIO	FY2015	FY2016	FY2017E	FY2018F
EPS (VND)	4,785	3,327	1,675	2,349
P/E (x)	9.2	9.6	14.93	11.00
BV (VND)	18,307	13,318	13,193	13,542
P/B (x)	2.4	2.4	2.4	2.4
DPS (VND/share)	3,000	2,800	1,800	2,000
Dividend yield (%)	6.8	8.8	6.4	7.1

VALUATION MODEL	Price	Weight	Average
FCFF	30,539	50%	15,269
P/E	25,844	50%	12,922
Target price (VND)			28,191

VALUATION HISTORY	Price	Recommendation	Period
14/07/2017	33,100	Accumulate	Long term

RESULT 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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