NAM KIM GROUP JSC (NKG – HSX)

Proving Its Capability

Particulars (VND bn)	Q1-FY17	Q4-FY16	+/- QoQ	Q1-FY16	+/- YoY
Net revenue	2,392	2,458	-3%	1,799	33%
PAT	156	66	138%	66	137%
EBIT	243	117	107%	105	132%
EBIT margin	10.2%	4.8%	540bps	5.8%	433bps

Sources: NKG, RongViet Research

Q12017 Performance: In Line with Our Expectation

- Nam Kim 3 Plant construction is going to finish.
- New strategic partners join ownership structure.
- Benefits from the new trade measures against imports, similar to HSG.
- Sales volume increased 10% YoY while revenue grew mostly by an improved ASP. Exports accounted for more than half of sales volume.

Q22017 Potential: Capacity Growth Contributes the Most to 2017 Performance

2017 is an important year, as Nam Kim 3 will raise NKG's total design capacity by more than double. Operation of the new production lines is going to play an important role in NKG's revenue growth. However, the company is going to experience the negative effects of the decreasing HRC price during the quarter. Our Q2 forecast includes VND3,385 billion and VND181 billion in revenue and NPAT respectively, equivalent to the YoY growth rates of 56% and -25%. The forecasted YoY deterioration in net profit is partly because Q22016 results were extraordinary because of extremely advantageous global steel price movements.

Valuation and Recommendation*: NKG has been delivering radical changes in its internal business performance, regarding production, sales and financial strength. Moreover, the company has been taking advantage of countervailing measures against Chinese steel in both Vietnam and other export markets. As the construction of the new plant is concluding, NKG's efficiency and profitability has been advancing to a new level, and the company has been making rapid improvements in its financial strength by successful private placements. Firmly maintaining the second highest rank in terms of capacity among local names, NKG's remarkable profit growth is offering the market an attractive valuation as the lowest P/E ticker among leading producers in the steel industry.*

We evaluate NKG price at ***VND39,800/share****, which is* ***23.4%*** *higher than the closing price on July 18th 2017 and recommend to* ***BUY*** *the stock in the* ***INTERMEDIATE TERM****. This target price is revised from that in our NKG Result Update report published on 01/11/2016 owing to an increase in our forecasts on NKG's 2017 and 2018 business results. However, investors might as well consider the dilution caused by the upcoming placement as NKG is planning for an issuance to strategic partners in the second half of 2017.*

BUY

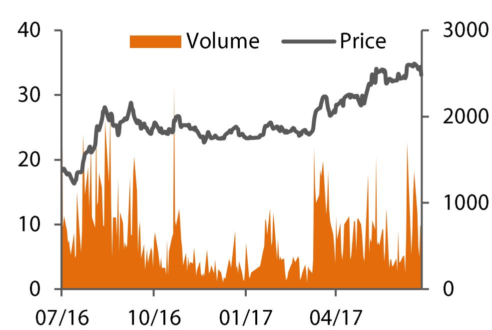
CMP (VND)	32,250
Target Price (VND)	39,800
Investment Period	**Intermediate-term**

Stock Info

Sector	Basic materials
Market Cap (VND B)	3,225
Current Shares O/S	100,000,000
Beta	1.32
Free float (%)	33.4
52 week High	34,850
52 week Low	16,333
Avg. Daily Volume (20 sessions)	654,007

	FY2016	Current
EPS	6,850	7,479
EPS Growth (%)	286.20	79.30
Diluted EPS	6,850	7,479
P/E	3.41	4.31
P/B	1.47	1.84
EV/EBITDA	6.51	7.11
Cash dividend	0	0
ROE (%)	46.36	49.51

Price performance



Major Shareholders (%)

P&Q Ltd	18.47
VEIL	15.00
Ho Minh Quang	13.44
Tran Uyen Nhan	11.84
Foreign ownership room (%)	18.44

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Exhibit 1: Q1FY17 Results

Particulars (VND bn)	Q1-FY17	Q4-FY16	+/- (QoQ)	Q1-FY16	+/- (YoY)
Net revenue	2,392	2,458	-2.7%	1,799	33.0%
Gross profit	307	242	26.6%	139	120.0%
SG&A	63	69	-9.0%	43	47.1%
Operating income	244	173	40.7%	97	152.0%
EBITDA	300	168	78.7%	142	110.4%
EBIT	243	117	107.4%	105	131.7%
Financial expenses	98	127	-23.4%	49	98.3%
- Interest Expenses	53	40	32.5%	27	96.4%
Dep. and amortization	56	50	11.9%	37	50.6%
Non-recurring items (*)					
Extraordinary items (*)					
PBT	191	78	145.8%	78	143.8%
PAT	156	66	137.5%	66	136.7%
(*) Adjusted PAT	156	66	137.5%	66	136.7%

Source: NKG, RongViet Research

Exhibit 2: 1QFY2017 Performance Analysis

Particulars	Q1-FY17	Q4-FY16	+/- QoQ	Q1-FY16	+/- YoY
Profitability Ratios (%)					
Gross Margin	12.8%	9.9%	297bps	7.8%	507bps
EBITDA Margin	12.5%	6.8%	571bps	7.9%	461bps
EBIT Margin	10.2%	4.8%	540bps	5.8%	433bps
Net Margin	6.5%	2.7%	385bps	3.7%	286bps
Adjusted Net Margin	6.5%	2.7%	385bps	3.7%	286bps
Turnover *(x)					
-Inventories	3.5	5.3	-1.7	6.5	-3.0
-Receivables	14.7	15.4	-0.7	11.6	3.1
-Payables	11.0	12.9	-1.8	8.6	2.4
Leverage (%)					
Total Debt/ Equity	221.6%	183.6%	3,807bps	324.7%	-10,309bps

Source: NKG, (*) Annualized turnover

Exhibit 3: Q2-FY17 Performance Forecast

Particulars (VND bn)	Q2-FY17	+/- QoQ	+/- YoY
Revenue	3,385	42%	56%
Gross profit	414	35%	16%
EBIT	337	38%	9%
NPAT	181	16%	-25%

Source: NKG, RongViet Research

Updates:

2017 is an important year, as Nam Kim 3 will more than double the total design capacity. As soon as the last GI/GL production line starts operation in December 2017, *Nam Kim 3 Plant* will increase NKG's total coated steel capacity to over 1.2 million tons per year, which means NKG will remain the second largest firm among Vietnamese participants. The plant is going to be the most well developed coated steel factory producing from HRC in the domestic market, hoping to help NKG gaining domestic market share gradually. We forecast that the new plant is going to run at the utilisation of 70% and 80% in 2017 and 2018 respectively, before operating at full capacity in 2019, which is one of the major growth drivers for NKG in the long term.

Nam Kim Long An Steel Pipe Plant is another part of NKG's market coverage expanding strategy. At the maximum actual capacity of 25,000 tons per month, the welding plant targets Mekong Delta consumers and NKG aims to reach the full-capacity utilization rate in 2-3 years, which means the plant will contribute nearly 300,000 tons of welded steel pipes into NKG's total consumption. In 2017, NKG's guidance volume for the plant is 90,000 tons.

Nam Kim Corea Project is considered as a breakthrough strategy as NKG decides to enter the home appliance's value chain. Affiliating with Unicoh from Korea, a current strategic shareholder, NKG is going to establish a VND160-billion charter capital firm (NKG contributes 25%, Unicoh 45%, NKG Chairman 30%), to produce parts for electrical home appliances including refrigerators, washing machines and air-cons. Using the high-quality as the base steel, the OEM production is expected by NKG management to bring about higher margins than the company's traditional products which are mostly used as construction materials. The affiliate is currently under legal procedure for establishment, whereas NKG representatives reported that the company may carry out construction in the near future in order to start operation in June 2018.

The cold-rolling lines are going to stabilise NKG's gross margin. NKG is going to operate a new cold-rolling line in 2017 and another one in 2018, remarkably easing the reliance on CRC purchases and improving NKG's gross margin. We forecast that from 2018 on, NKG is capable of producing over 60% of their needed CRC amount, higher than that of 2016 (35%). Consequently, NKG is going to experience an improvement in gross margin by 90bps in 2017 and 96bps in 2018 thanks to the production process moving upstream.

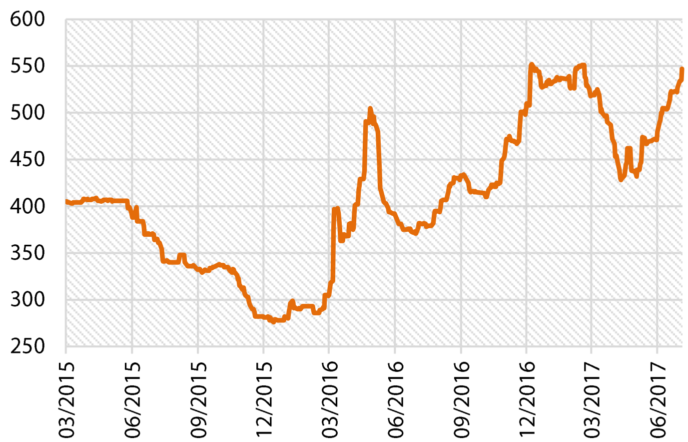
NKG is making continuous efforts in improving its financials. After concluding two private placements during 2016 and proceeding over VND430 billion for new machineries, the 1-trillion-charter-capital firm now continues to seek funding from strategic partners. According to the latest updates, NKG is going to propose a resolution allowing a private placement of a maximum of 30 million shares to strategic investors. As the company is known for issuing shares at an 18-22% discounted price compared to the market price, we estimate the issuance price for this placement at around VND26,000 per share, which is 25% lower than the average closing price of the most recent 10 trading sessions. Accordingly, NKG will proceed a maximum amount of VND780 billion. All of the projects mentioned above need funding of an estimated VND400 billion, provided that NKG borrows 70% of the total investment value. Moreover, NKG's current debts/assets ratio is already 78%, very high and risky, which needs restructuring, thus parts of the proceeds may be used for improving NKG's financial strength. NKG is holding an extraordinary GM on July 22nd to make important decisions regarding the plan, on which we will update the details soon.

"Short-term" investors should evaluate the dilution effects on the stock price potential. NKG might have to achieve its long-term financial stability by giving up its shareholder's rights in the short term, because the private placements is going to create a dilution rate of maximum 30% for most current shareholders. Except for the few major members who are eligible to take part in the placement deal, investors might see NKG's EPS diluted by 30%. In our forecast, we assume NKG issues 20 million shares at VND26,000 per share, which produces an FCFE valuation of over VND5,000 billion for the equity value, equivalent to VND42,163 per share at the fully diluted O/S numbers of 119 million.

Regarding NKG's valuation methods, the above FCFE value implies a forward P/E of 5.62x, which we consider suitable for NKG under the current business performance. However, we only use the forward P/E ratio of 5.0x in our valuation because we suppose the company needs more time to prove its ability to maintain a stable growth after a period of surging profits and only then can the company deserves a higher P/E. In contrast, "long-term" investors might as well consider that NKG's 2018 EPS (fully diluted) is forecasted at over 10,000 dong per share, which means that even if the same P/E is applied, NKG's upside for the next year is still enormously attractive.

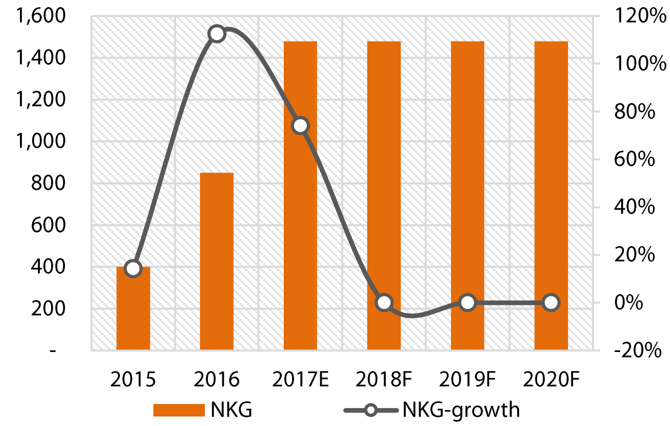
Appendix:

Figure 1: HRC Price (USD per ton)



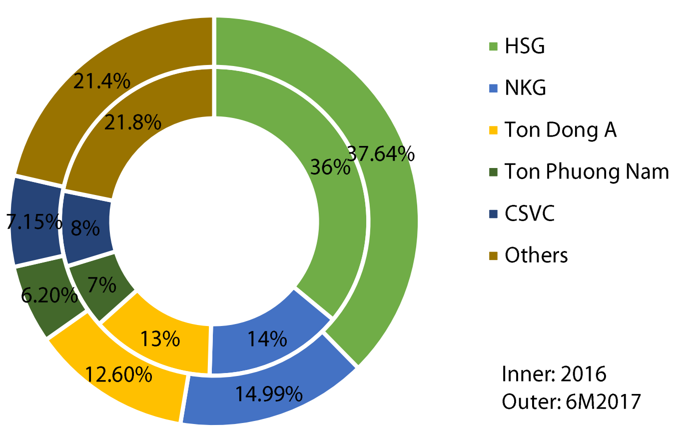
Source: VSA

Figure 2: NKG's Capacity Expansions



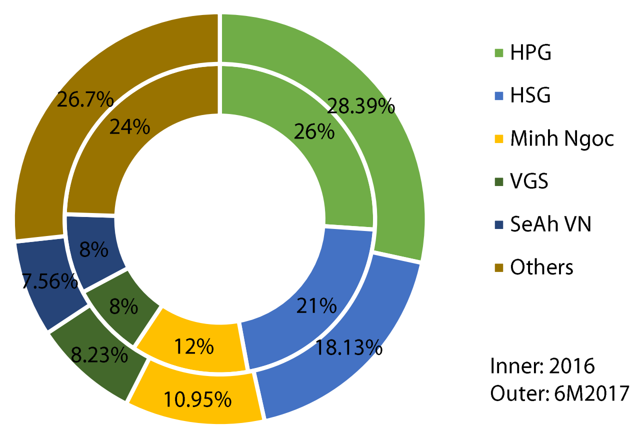
Source: RongViet Research forecasts

Figure 3: Coated Steel Market Share



Source: VSA

Figure 4: Steel Pipe Market Share



Source: VSA

VND billion

INCOME STATEMENT	FY2015	FY2016	FY2017E	FY2018F
Revenue	5,751	8,936	13,817	18,549
COGS	5,304	7,924	12,128	16,104
Gross profit	447	1,012	1,689	2,444
Selling Expense	95	162	249	325
G&A Expense	42	54	65	74
Finance Income	42	110	4	3
Finance Expense	195	299	378	428
Other profits	0	0	0	0
PBT	156	608	1,002	1,619
Prov. of Tax	30	90	180	282
Minority's Interest	0	0	1	1
PAT to Equity S/H	126	518	821	1,337
EBIT	310	796	1,375	2,045
EBITDA	432	963	1,731	2,518

%

FINANCIAL RATIO	FY2015	FY2016	FY2017E	FY2018F
Growth				
Revenue	-1.5%	55.4%	54.6%	34.2%
EBITDA	52.5%	122.7%	79.8%	45.5%
EBIT	64.1%	157.1%	72.7%	48.7%
PAT	64.5%	310.8%	58.6%	62.8%
Total assets	21.6%	78.9%	32.1%	19.5%
Total equity	26.3%	146.6%	78.2%	32.5%
Profitability				
Gross margin	7.8%	11.3%	12.2%	13.2%
EBITDA margin	7.5%	10.8%	12.5%	13.6%
EBIT margin	5.4%	8.9%	10.0%	11.0%
Net margin	2.2%	5.8%	5.9%	7.2%
ROA	3.5%	8.1%	9.7%	13.2%
ROCE	21.3%	23.1%	28.9%	34.4%
ROE	19.7%	32.8%	29.2%	35.9%
Efficiency				
Receivables turnover	10.8	18.0	18.0	18.0
Inventories turnover	4.8	3.9	3.6	3.8
Payables turnover	5.6	12.2	11.1	11.1
Liquidity				
Current	0.9	1.0	1.3	1.4
Solvency				
Total Debt/Equity	309.2%	263.5%	161.0%	131.6%
Current Debt/Equity	182.3%	145.5%	92.3%	72.4%
Long-term Debt/Equity	126.9%	117.9%	68.7%	59.2%

VND billion

BALANCE SHEET	FY2015	FY2016	FY2017E	FY2018F
Cash and cash equivalents	51	174	163	231
Short-term investments	0	26	29	29
Accounts receivable	533	496	767	1,030
Inventories	1,098	2,033	3,396	4,187
Other current assets	147	346	415	498
Property, plant & equipment	1,657	3,233	3,588	4,033
Acquired intangible assets	60	59	57	56
Long-term investments	0	0	0	0
Other non-current assets	25	24	25	26
Total assets	**3,572**	**6,390**	**8,440**	**10,090**
Accounts payable	953	649	1,092	1,449
Short-term borrowings	1,166	2,296	2,596	2,696
Long-term borrowings	812	1,860	1,931	2,206
Other non-current liabilities	1	1	1	2
Bonus and Welfare fund	0	4	6	10
Technology-science, dev. fund	0	0	0	0
Total liabilities	**2,933**	**4,810**	**5,626**	**6,363**
Common stock and APIC	**2,933**	**4,810**	**5,626**	**6,363**
Treasury stock (enter as -)	501	925	1,775	1,775
Retained earnings	129	635	978	1,824
Other comprehensive income	1	5	5	5
Inv. and Dev. Fund	9	13	54	121
Total equity	**640**	**1,577**	**2,811**	**3,724**
Minority Interest	**0**	**0**	**0**	**0**

VALUATION RATIO	FY2015	FY2016	FY2017E	FY2018F
EPS (dong)	1,151	4,966	7,497	10,667
P/E (x)	3.9	3.0	4.6	3.2
BV (dong)	14,576	23,888	23,616	31,283
P/B (x)	0.5	1.0	1.5	1.1
DPS (dong/cp)	0	0	1,000	3,000
Dividend yield (%)	0	0	2.9%	8.7%

VALUATION MODEL	Price	Weight	Average
FCFE	42,163	50%	21,081
P/E	37,485	50%	18,743
Target price (dong/share)		100%	39,800

VALUATION HISTORY	Price	Recommendation	Period
06/11/2015	8,947	Neutral	Intermediate
1/11/2016	30,466	Buy	Intermediate

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