HOA SEN GROUP JSC (HSG – HSX)

Robust Core Business

Particulars (VND bn)	Q2-FY16/17	Q1-FY16/17	+/- QoQ	Q2-FY15/16	+/- YoY
Net revenue	6,213	5,767	8%	4,384	42%
PAT	416	440	-6%	418	-1%
EBIT	700	537	30%	587	19%
EBIT margin	11.3%	9.3%	196bps	13.4%	-213bps

Source: HSG, RongViet Research

1H/FY2016-2017 Performance: Tracking Closely to the Guidance

- Continuously expanding capacity with the encouraged set-up progress.
- Gross margin dropped under pressures from input price movements.
- New trade measures against imports are in favour of the industry's leader.
- Postponing Ca Na Steel Complex is not a bad news.

Q3FY2016-2017 Potential: Focusing on Core Business is the Key to Growth

Our forecast includes a 9.1% volume growth, 23% revenue growth and -5% NPAT growth due to HRC price peaking at over USD530 per ton in March. This forecast is similar to our previous Result Update, as the effects of the HRC price movement has been included in the prediction. The new trade protection against coated steel imports would be a supportive news for HSG's Q4 potential rather than a noticeable performance boost. We have noticed that the HRC price is recovering while HSG's inventory is not necessarily expensive. In fact, HSG is capable of maintaining the ability to control input prices' effects owing to the nation-wide retail system.

***Valuation and Recommendation**: As all the duties on coated steel imports are in favor of HSG, the company can take advantage of the ability to control negative effects of the unfavourable HRC price movement to stabilising their profitability. However, we expect HSG to see a moderate decrease in their gross margin, thus a slightly lower quarterly bottom line YoY. Importantly, Ca Na project being called off can be a positive sign, as HSG can stay focused on its core business, which is still highly profitable.*

*We evaluate HSG price at **VND36,300/share**, which is **20.8%** higher than the closing price on 18th July 2017 and we recommend to **BUY** the stock in the **Intermediate-term**. This target price is revised from that in HSG Company Report published in March 2017 because we consider HSG to deserve a higher P/E ratio based on its remarkable performance and the recent market sentiment on the stock. The stock price has increased strongly since the 75% share dividends were delivered in May, thus the upside is unattractive. However, investors might as well hold the stock for FY2016-2017, as we anticipate an upside catalyst regarding Hoa Sen - Germadept port in Q4.*

BUY

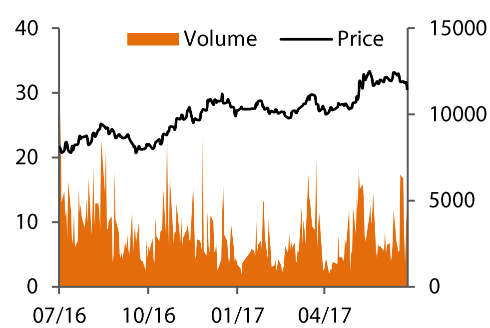
CMP (VND)	30,050
Target Price (VND)	36,300
Investment Period	**Intermediate-term**

Stock Info

Sector	Basic materials
Market Cap (VND B)	10,709
Current Shares O/S	349,996,683
Beta	1.33
Free float (%)	40.0
52 week High	33,300
52 week Low	20,706
Avg. Daily Volume (20 sessions)	3,062,677

	FY15-16	Current
EPS	4,200	5,445
EPS Growth (%)	120.24	-0.76
Diluted EPS	4,200	5,445
P/E	5.71	5.52
P/B	2.00	2.22
EV/EBITDA	5.02	7.33
Cash dividend	2,500	1,000
ROE (%)	41.04	42.67

Price performance



Major Shareholders (%)

Hoa Sen Inv. Group Ltd	25.69
Hoa Sen Inv. & Tourism Ltd	20.61
Tam Thien Tam Co.	6.92
Le Phuoc Vu	4.78
Foreign ownership room (%)	19.41

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Exhibit 1: Q2/FY16-17 Results

Particulars (VND bn)	Q2-FY16/17	Q1-FY16/17	+/- (QoQ)	Q2-FY15/16	+/- (YoY)	2Q-FY17	+/-(YoY)
Net revenue	6,213	5,767	7.7%	4,384	41.7%	11,980	44%
Gross profit	1,157	1,047	10.5%	1,097	5.4%	2,203	26%
SG&A	457	509	-10.3%	510	-10.5%	966	12%
Operating income	700	537	30.4%	587	19.2%	1,238	27%
EBITDA	866	693	24.9%	720	20.3%	1,559	36%
EBIT	700	537	30.4%	587	19.2%	1,238	40%
Financial expenses	191	86	122.7%	70	171.5%	277	110%
- Interest Expenses	129	65	99.5%	54	138.0%	194	79%
Dep. and amortization	166	156	6.2%	133	24.9%	322	23%
Non-recurring items (*)							
Extraordinary items (*)							
PBT	539	515	4.6%	531	1.5%	1,054	41%
PAT	416	440	-5.5%	418	-0.6%	856	33%
(*) Adjusted PAT	416	440	-5.5%	418	-0.6%	856	33%

Source: HSG, RongViet Research

Exhibit 2: 2QFY2016-2017 Performance Analysis

Particulars	Q2-FY16/17	Q1-FY16/17	+/- (QoQ)	Q2-FY16/17	+/- (YoY)
Profitability Ratios (%)					
Gross Margin	18.6%	18.1%	0.5%	25.0%	-6.4%
EBITDA Margin	13.9%	12.0%	1.9%	16.4%	-2.5%
EBIT Margin	11.3%	9.3%	2.0%	13.4%	-2.1%
Net Margin	6.7%	7.6%	-0.9%	9.5%	-2.8%
Adjusted Net Margin	6.7%	7.6%	-0.9%	9.5%	-2.8%
Turnover *(x)					
-Inventories	3	4	-0.8	5	-1.8
-Receivables	13.9	15.4	-1.6	21.5	-7.7
-Payables	13	10	3.2	10	3.1
Leverage (%)					
Total Debt/ Equity	253.8%	167.3%	86.5%	131.1%	122.7%

Source: HSG, (*) Annualized turnover

Exhibit 3: Q3-FY16/17 Performance Forecast

Particulars (VND bn)	Q3-FY16/17	+/- QoQ	+/- YoY
Revenue	5,630	-9%	23%
Gross profit	1,005	-13%	-10%
EBIT	515	-26%	-19%
NPAT	426	2%	-5%

Source: HSG, RongViet Research

Exhibit 4: Q2-FY16/17 Performance Forecast vs Results

Particular (VND bn)	Actual	Projected	Dif. (%)
Net revenue	6,213	6,746	-8%
Gross profit	1,157	1,298	-11%
EBIT	700	651	8%
PAT	416	435	-4%

Source: HSG, RongViet Research

Updates:

The new trade protection against coated steel imports is a supportive news for HSG's business results. MoIT has just announced the official protection measure on color coated steel imports, effective from June 15 2017. Even though the duty rate is not as expected, we predict that HSG is going to benefit directly from the decision as RongViet Research estimates that color coated steel accounted for over 25% of HSG's total revenue (FY2015-2016). This is also an opportunity for HSG and other firms to take over market shares from the Chinese imports and to raise the sale prices. In fact, HSG has just made the first move increasing their coated steel prices slightly in early July, which display its ability to control input prices' effects via the nation-wide retail system.

HRC price is recovering while HSG's inventory is not necessarily expensive. As HSG's inventory was record-high in the last quarterly report, which was VND8,465 billion, causing concerns over the risk of incurring provisions. Indeed, the reported amount of goods in transit and input was over VND5,500 billion at the end of Q2/FY16-17, nearly double that of Q1. However, considering HRC price movement during January-March 2017 period, it can be inferred that HSG's entire inventory was not necessarily purchased at high prices. According to HSG's representative, the average stored input can be sufficient for two months of production, thus HSG is capable of limiting purchases during HRC price's unfavourable fluctuations. Despite the fact that HRC price surged during the quarter and peaked at over USD520 per ton, the batch of imports with the highest price that HSG bought was worth around USD480 per ton. We observed that HRC price is currently picking up from USD430 in April, which can be inferred that HSG is unlikely to make a large amount of provision that it could impact their performance in Q3 and Q4/FY16-17.

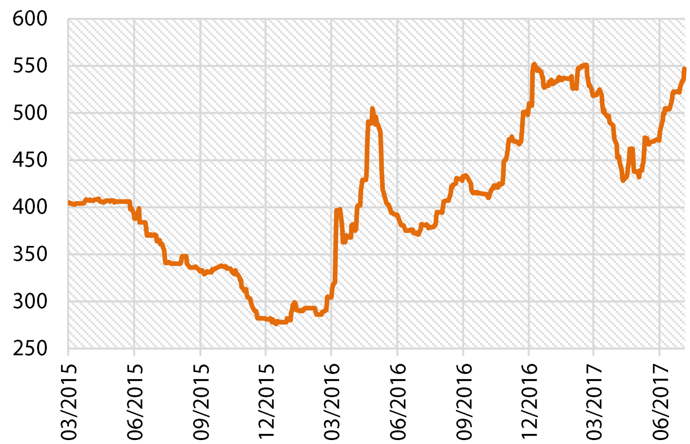
Ca Na's postpone may not be a bad news after all because HSG still has potential growth drivers. The initial outlay can be over USD1 billion which is a massive project for HSG, as we consider the firm's capability to be sufficient for projects that are of the same size as their current ones. Therefore, we hold the view that this news is a positive sign, which implies that HSG can now focus on its core business of steel and plastic products. Beside the established power in the steel industry, HSG has one of the largest capacities in the domestic plastic pipe market while the utilisation ratio is only around 50%, which means ample room for volume growth. HSG is also carrying out aggressive marketing and discount policies to take over market share with the assistance of their well-developed nation-wide retail system. We expect the plastic pipe business to be an ace in HSG's long-term growth story, as HSG's ambition for the plastic business has caused concern among its competitors.

Whereas the project's initiation might have taken most investors by surprise because of its unexpected pace, it has been consistent regarding the company's tradition that decisions are quickly made and implemented. This results from the fact that very few individuals hold the highest power of deciding in HSG, which has played a significant role in Hoa Sen's growth owing to the timeliness and the progress pace. However, the dependence exposes HSG to the risk that concerns the few individuals, where their actions if unfavourably interpreted by the market can cause pressures on the stock price.

Sales of Hoa Sen Germadept port can bring about an extraordinary profit for the year. According to Germadept Corporation (GMD-HSX), they have signed a memo with a Korean buy-side to transfer the port, which HSG holds 45% ownership. Based on the information announced by GMD management, we estimate that HSG could recognise VND89 billion net profit from the deal, including reversals of the provisions made for the investment in the past years. We forecast that HSG can record nearly VND500 billion NPAT for Q4, +16% compared to Q3 thanks to the extraordinary profit.

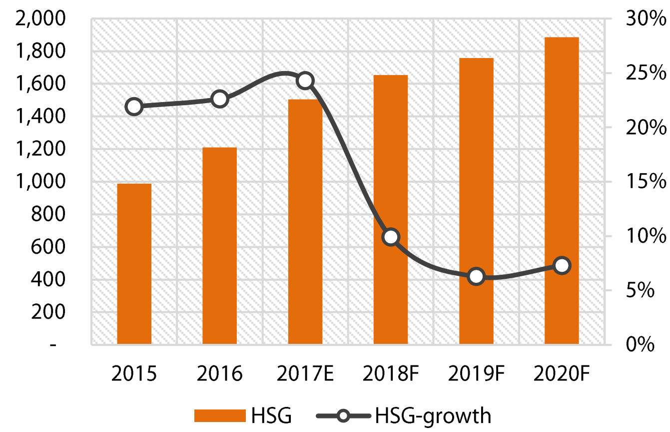
Appendix:

Figure 1: HRC Price (USD per ton)



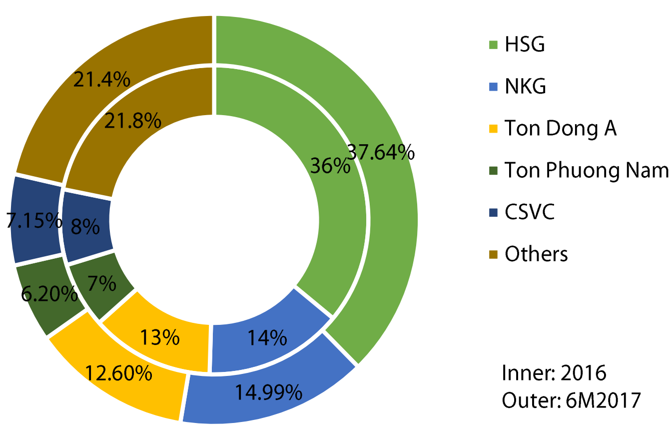
Source: VSA

Figure 2: HSG's Capacity Expansion (thousand tons)



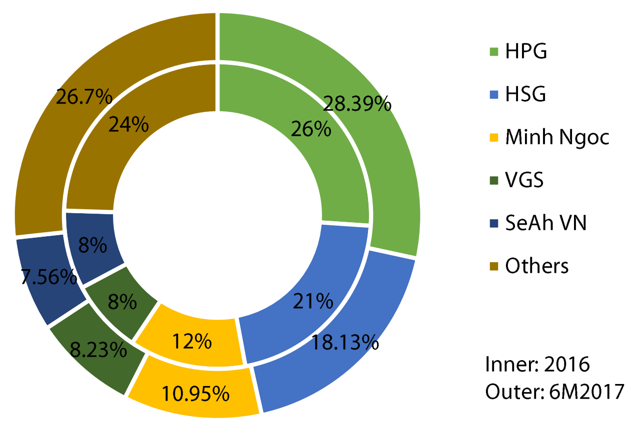
Source: RongViet Research forecasts

Figure 3: Coated Steel Market Share



Source: VSA

Figure 4: Steel Pipe Market Share



Source: VSA

VND billion

INCOME STATEMENT	FY14-15	FY15-16	FY16-17E	FY17-18F
Revenue	17,447	17,886	23,239	28,214
COGS	14,869	13,708	19,026	23,270
Gross profit	2,578	4,178	4,213	4,944
Selling Expense	864	1,103	1,209	1,468
G&A Expense	512	917	646	824
Finance Income	32	38	25	36
Finance Expense	425	274	331	364
Other profits	24	-2	89	0
PBT	832	1,921	2,139	2,325
Prov. of Tax	179	420	361	417
Minority's Interest	0	0	0	0
PAT to Equity S/H	653	1,501	1,778	1,907
EBIT	1,202	2,158	2,357	2,653
EBITDA	1,664	2,675	3,166	3,598

%

FINANCIAL RATIO	FY14-15	FY15-16	FY16-17E	FY17-18F
Growth				
Revenue	16.4%	2.5%	29.9%	21.4%
Operating Income	63.6%	60.8%	18.4%	13.6%
EBITDA	75.6%	79.6%	9.2%	12.5%
PAT	59.1%	129.9%	18.5%	7.3%
Total Assets	-7.5%	30.4%	15.8%	16.1%
Equity	22.3%	41.8%	35.3%	25.5%
Profitability				
Gross margin	14.8%	23.4%	18.1%	17.5%
EBITDA margin	9.5%	15.0%	13.6%	12.8%
EBIT margin	6.9%	12.1%	10.1%	9.4%
Net margin	3.7%	8.4%	7.7%	6.8%
ROA	6.9%	12.2%	12.5%	11.5%
ROE	22.4%	36.4%	31.8%	27.2%
Efficiency				
Receivable Turnover	23.1	16.3	17.7	18.5
Inventory Turnover	4.2	2.8	3.8	3.7
Payable Turnover	14.5	5.8	8.6	8.5
Liquidity				
Current	0.9	1.0	1.2	1.4
Solvency				
Total Debt/Equity	188.7%	140.2%	114.8%	96.3%
Current Debt/Equity	155.3%	105.8%	80.0%	65.2%
Long-term Debt/Equity	33.3%	34.4%	34.8%	31.2%

VND billion

BALANCE SHEET	FY14-15	FY15-16	FY16-17E	FY17-18F
Cash and cash equivalents	277	577	1,069	1,377
Short-term investments	0	0	0	0
Accounts receivable	755	1,098	1,313	1,523
Inventories	3,544	4,822	4,981	6,358
Other current assets	593	562	674	809
Property, plant & equipment	3,740	4,591	5,538	5,791
Acquired intangible assets	295	293	290	287
Long-term investments	38	26	26	26
Other non-current assets	199	342	359	377
Total assets	**9,441**	**12,310**	**14,250**	**16,549**
Accounts payable	1,025	2,360	2,212	2,744
Short-term borrowings	4,521	4,366	4,466	4,566
Long-term borrowings	970	1,419	1,944	2,183
Other non-current liabilities	5	4	4	5
Bonus and Welfare fund	8	31	37	39
Technology-science, dev. fund	0	0	0	0
Total liabilities	**6,530**	**8,180**	**8,663**	**9,538**
Common stock and APIC	1,495	2,517	4,052	4,052
Treasury stock (enter as -)	-52	0	0	0
Retained earnings	1,453	1,603	1,525	2,949
Other comprehensive income	7	7	7	7
Inv. and Dev. Fund	9	0	0	0
Total equity	**2,911**	**4,127**	**5,584**	**7,007**
Minority Interest	**0**	**3**	**3**	**3**

VALUATION RATIO	FY14-15	FY15-16	FY16-17E	FY17-18F
EPS (dong)	1,878	4,317	4,756	5,102
P/E (x)	12.1	5.8	6.9	6.5
BV (dong)	28,879	20,996	15,953	20,021
P/B (x)	1.4	2.1	2.1	1.6
DPS (dong/cp)	1,500	2,500	1,000	1,000
Dividend yield (%)	3.7%	6.0%	3.0%	3.0%

VALUATION MODEL	Price	Weight	Average
FCFE	37,603	30%	11,281
PE	35,669	70%	24,968
Target price (dong)			**36,300**

VALUATION HISTORY	Price	Recommendation	Period
29/10/2015	18,457	Accumulate	Long term
22/03/2017	28,971	Neutral	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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