

## Hoa Sen Group (HSG – HSX)

The hard part has gradually done!

Particulars (VND bn)	Q3-FY13/14	Q2-FY13/14	+/- qoq	Q3-FY13/14	+/- yoy
Net Revenues	4,325.4	3,342.2	29%	3,261.5	33%
EBIT	110.9	67.8	64%	185.4	-40%
PAT	183.4	133.1	38%	265.6	-31%
EBIT margin (%)	4.2%	4.0%	26bps	8.1%	-390bps

Sources: HSG

- Disappointed earnings in the first 3 quarters of the fiscal year.
- Speeded expansion of capacity and distribution network.
- Disadvantages of HSG' cash management model in expansion phase.
- FY 2013-2014 business' prospect.

### Outlook and Valuation:

HSG is pursuing a blitz strategy in its investments in order to take advantage of economies of scale. In comparison with its peers, HSG has cutting-edge technologies and has been quite successful in establishing itself as a prestigious brand. Those, in combination with a wide distribution network are the reasons why we think HSG will succeed in increasing sales volume and revenue. Nonetheless, expanding production scale and markets are not easy tasks. For instance, the Company has had to sacrifice a portion of its profit margins to push sales in the context of high material price volatility. Moreover, the increase of the debt burden makes the impact of financial expenses on net income increasingly concerning. In FY2013-14, we forecast that HSG's sale volume will continue to increase such that revenue will reach about VND15,415 bn (+31% yoy) and net profit about VND399 bn (-38% yoy), translating to EPS of VND4,140.

Based on relative valuation, we think current market price of HSG has reflected reasonable company prospect for FY 2013-2014. However, with the brighter expectation for the next fiscal year, we suppose that investor could consider HSG as an investment opportunity if its gross margin shows a positive shift, especially in Q1 of FY2014-2015. Based on 3 valuation methods, i.e. the 5-year cash flow for the firm discount model (FCFF), the P/E approach and EV/EBITDA method, we estimate that the intrinsic per-share value of HSG is **VND48,100**. In comparing this with the closed price as of August 20, 2014, we rate the stock as **ACCUMULATE** in the **INTERMEDIATE** term.

### Key financials

Y/E Dec ( VND bn)	FY11/12	FY12/13	9M-FY13/14	FY13/14E	FY14/15F
Net Revenues	10,088.0	11,759.9	10,966.0	15,414.6	17,869.8
% chg	23.5%	16.6%	28.1%	31.1%	15.9%
PAT	368.1	580.8	281.4	398.7	612.1
% chg	129.8%	57.8%	-47.7%	-31.4%	53.5%
EBIT margin (%)	3.6%	4.9%	2.6%	2.6%	3.4%
ROA (%)	6.6%	9.3%		5.4%	7.8%
ROE (%)	19.4%	27.5%		17.4%	24.0%
EPS (VND)	3,761	5,941		4,140	6,355
Adjusted EPS (VND)	2,195	5,941		4,140	6,355
Book value (VND)	20,027	21,931		23,511	27,084
Cash dividend (VND)					
P/E (x)	4.6	6.7		10.9*	6.5*
P/BV (x)	0.9	1.8		1.8*	1.5*

Sources: HSG, RongViet Securities, \*Stock price as of 20/08/2014

Please refer to important disclosures at the end of this report

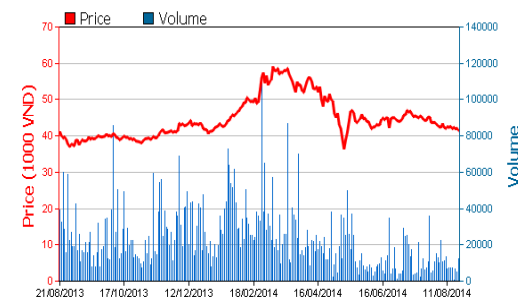
## ACCUMULATE

CMP (VND)	41.500
Target Price (VND)	48.100

Investment Period Intermediate

### Stock Info

Sector	Basic Resources
Market Cap ( VND bn)	3,997
Current Shares O/S	96,313,098
Beta	1.71
Free float (%)	25.81
52 weeks High	58,233
52 weeks Low	35,135
Avg. Daily Volume (in 20 sessions)	107,795



### Performance (%)

	3M	1Y	3Y
HSG	-9.8%	-1.2%	371.6%
Basic Resources	4.2%	32.7%	#DIV/0!
VN30 Index	9.3%	15.8%	49.2%
VNIndex	12.9%	20.2%	51.4%

### Major Shareholders (%)

Tam Hy Company	22.84
Le Phuoc Vu	17.05
Red River Holdings	16.47
Foreign' Investor Room (%)	7

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**Exhibit 1: 3QFY13/14 and YTD Results**

Particulars (VND bn)	Q3-FY13/14	Q2-FY13/14	+/- (qoq)	Q3-FY12/13	+/- (yoy)	9M - FY13/14	+/- (yoy)
Net Revenues	4,325.4	3,342.2	29.4%	3,261.5	32.6%	10,966.0	28.1%
Gross profits	453.8	386.8	17.3%	502.5	-9.7%	1,244.7	-8.7%
SG&AC	284.9	265.9	7.2%	227.4	25.3%	775.2	33.3%
Operating Income	126.0	69.5	81.4%	215.5	-41.5%	322.3	-47.8%
EBITDA	275.9	216.3	27.5%	342.4	-19.4%	758.6	-23.5%
EBIT	183.4	133.1	37.8%	265.6	-31.0%	504.8	-34.7%
Financial expenses	53.4	61.2	-12.8%	74.8	-28.7%	173.4	-9.8%
- Interest Expenses	39.5	50.7	-22.1%	46.2	-14.5%	137.2	-8.1%
Dep. and amortization	-92.5	-83.3	11.0%	-76.7	20.5%	-253.8	16.2%
Non-recurring Items (*)							
Extraordinary Items (*)	17.9	12.9	38.7%	3.9	358.0%		
PBT	143.9	82.4	74.7%	219.5	-34.4%	367.5	-41.1%
PAT	110.9	67.8	63.6%	185.4	-40.2%	281.4	-47.7%
(*) Adjusted PAT	97.1	57.1	69.9%	182.1	-46.7%	281.4	

Sources: HSG, RongViet Securities

**Exhibit 2: Q3-FY13/14 performance analysis**

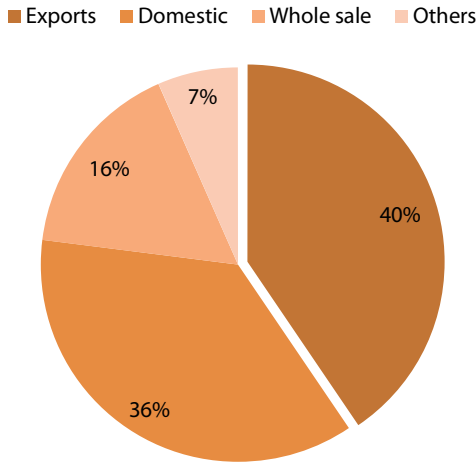
Particulars	Q3-FY13/14	Q2-FY13/14	+/- (qoq)	Q3-FY12/13	+/- (yoy)
<b>Profitability Ratios (%)</b>					
Gross Margin	10.5%	11.6%	-108bps	15.4%	-491bps
EBITDA Margin	6.4%	6.5%	-10bps	10.5%	-412bps
EBIT Margin	4.2%	4.0%	26bps	8.1%	-390bps
Net Margin	2.6%	2.0%	54bps	5.7%	-312bps
Adjusted Net Margin	2.2%	1.7%	53bps	5.6%	-334bps
<b>Turnover *(x)</b>					
-Inventories	4.8	3.3	1.5	4.2	0.6
-Receivables	20.6	16.0	4.6	21.6	-1.0
-Payables	20.7	10.7	10.1	14.6	6.2
<b>Leverage (%)</b>					
Total Debt/ Equity	2.4	3.0	-0.7	2.0	0.4

Sources: HSG, RongViet Securities (\*) Annualized turnover

**Disappointed earnings in the first 3 quarters of this fiscal year.**

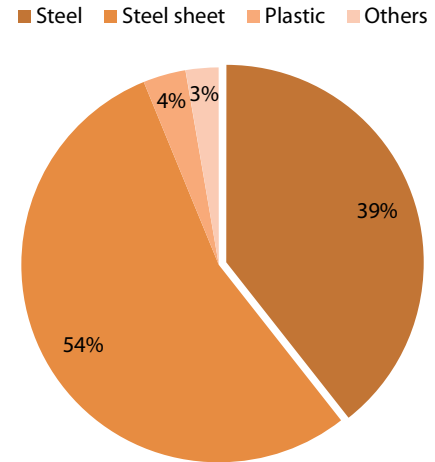
In the first 3 quarters of FY2013-14, the Company reported a 36.8-percent increase in sales volume to 595,911 tons. As the result, revenue also increased sharply to VND10,966 bn (+28.1% from a year earlier). We saw a dramatic change in the net sales structure during the period wherein the share of domestic sales in total sales increased to 36.5% while that of exports decreased to 40.5%. The increase of local sales may be caused by the expansion of retail distribution since the early of the fiscal year, company opened 2-3 new outlets per month average. By product, steel sheet remained the primary sale, accounting for 54% of net sales with the total consumption volume up to 454,000 tons in the first 9 months of the fiscal year.

**Figure 1: Sales by distribution channels**



Source: HSG

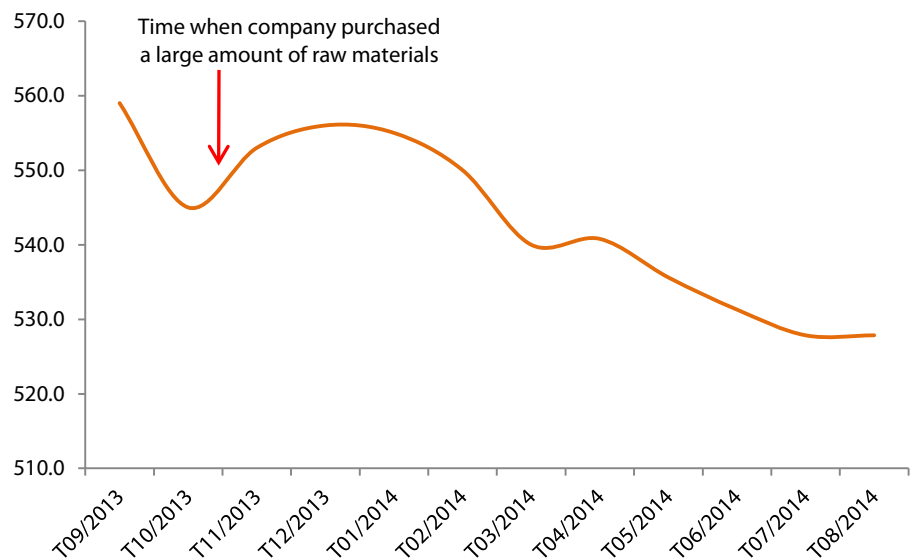
**Figure 2: Sales by products**



Source: HSG

Though revenue grew remarkably, the gross profit margin dropped sharply to 11.4% (as compared to 16% FY2012-13). We suppose this was because the Company did not benefit as much from raw material speculation as it had previously done. In November 2013, HSG signed contracts to buy approximately 500,000 tons HRC at the 550-560 USD/ton, said BoD Chairman Le Phuoc Vu at the FY2012-2013 AGM. However, the downtrend in HRC price has since marched on, forcing the Company to push sales in its distribution channels in order to liquidate the remaining high-cost inventories of finished products. The average selling price in the first 3 quarters of FY2013-2014 decreased 6% to VND18.4 million/ton. After 9 months, net profit reached only VND281.4 bn, a 48-percent decrease from a year earlier and an equivalent to 47% of the fiscal year' profit target.

**Figure 3: Hot Rolled Coil (HRC) price**



Source: HSG, Bloomberg

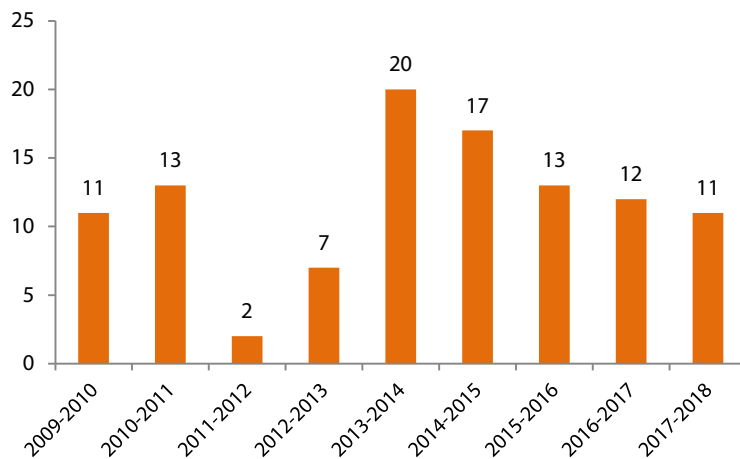
**Speeding expansion of capacity and distribution network.**

The completion of Hoa Sen Phu My Steel Sheet Plant Phase 2 would help HSG increase its cold rolling capacity by 69% to 980,000 tons/year in 2014; the cold rolling line No. 4 was put into operation on schedule in June and another will have been operational by September 2014. Aside from the two cold rolling lines, a 150,000-ton-per-year coating line and a 400,000-ton-per-year hot galvanizing line were completed in early 2014.

We expect the gross profit margin of HSG to increase after the completion of the second phase as: (1) enlarged capacity in the cold rolling line will reduce outside service costs; (2) hot dip galvanized steel (HGI) is now HSG’s strength, standing second only to galvalume steel sheet (GL) in term of sales with its share in total sales having increased from 15.4% in FY 2012-2013 to 18.8% in 1H FY 2013-2014. HGI consumption prospect is fairly encouraging given its wide variety of applications in both civil and industrial production. Moreover, HGI offers one of the highest profit margins in all of HSG’s products.

In parallel with the expansion of capacity, HSG has planned to increase the number of retail outlets in the local market from now to 2018. Since the beginning of the fiscal year, the Company has continuously opened new outlets and already met its goal to open 20 new outlets in FY2013-2014. According to the Company, the nationwide distribution network is one of its competitive advantages at the moment. It allows HSG to be more flexible both in its sales policy and in dealing with material price volatility. In the near future, the opening of new outlets should result in a growth of market share. However, such strategy may also result in higher management risk while requiring more inventories to be maintained within the system.

**Figure 4: New retail outlets (2009-2018)**



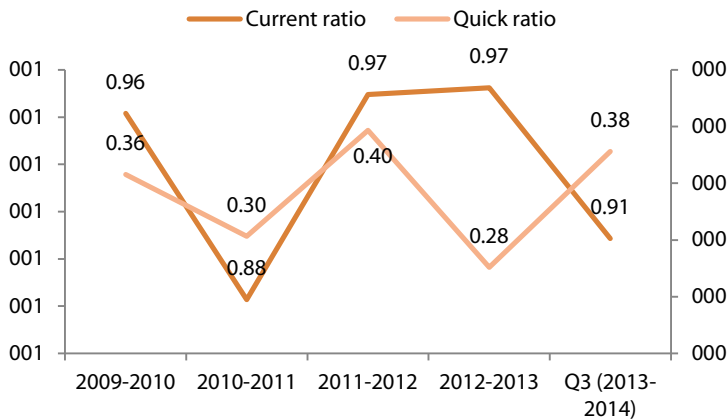
Source: HSG

For exports, the Company has distribution channels in more than 40 countries all over the world with above 50% of its exports coming from South East Asian region but only small portion from the other markets, including developed countries under the TPP. The current structure of exports plays an important role in mitigating exchange rate risk; it also enables the Company to borrow USD at low interest rate while gaining more flexibility in its sales policy. For upcoming periods, HSG intends to increase the share of exports in its net revenue to 50%, which we see highly possible given the prospect of Vietnam’s signing into trade agreements such as the Vietnam-EU FTA and the TPP.

**Disadvantages of HSG’ cash management model in expansion phase.**

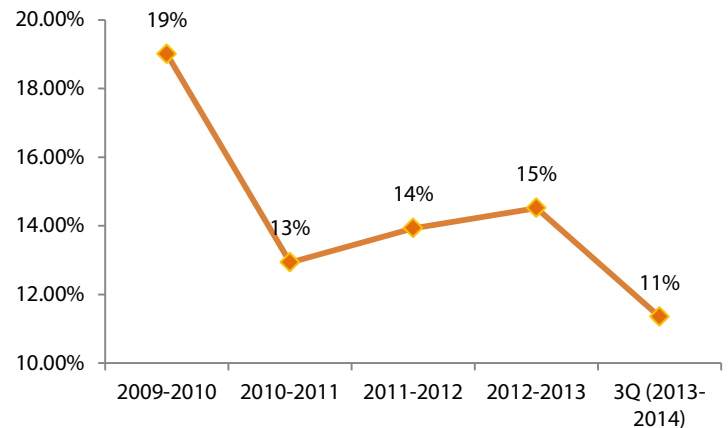
For its unique style of management, the Company usually maintains only a low amount of cash in hand during the business cycle, about VND100-150 bn average; working capital is funded mostly with short-term borrowings. This management model has put the Company’s liquidity in alert with both current ratio and quick ratio being lower than 1; the risk appears even higher when the firm expand its business. In FY2010-11, for example, when Phase 1 of Hoa Sen Phu My steel sheet plant was put into operation, the current ratio decreased to 0.88 times and gross profit margin to only 12.9% from the average of 19% during FY 2009-2010.

**Figure 5: Liquidity ratios**



Source: HSG, RongViet Securities

**Figure 6: Gross profit margin**



Source: HSG, RongViet Securities

From our perspective, the Company has been in same situation again in FY 2013-2014. In order to prepare for new production lines of Phu My Plant Phase 2, the Company has invested heavily in materials. The fact that the Company stepped up in its material purchase (mainly HRC) while HRC price was falling put a heavy downward pressure on the profit margins, gross profit margin in the first 3 quarter of the fiscal year was only 11.4%. Nonetheless, we think company has fixed its mistake partly through pushing production and sales. The financial report at the end of Q3 showed that company has dealt a large number of inventories of raw materials. So that, inventories of raw materials decreased to VND392 bn, a sharp fall compared to the earlier two quarters. However, inventory of finished goods was still high and company must continue to intensify sales in the last quarter. We suppose this may be one of the reasons that HSG has expanded its retail distribution rapidly since the early of this fiscal year and the number of new outlets exceeded this year plan .

**FY 2013-2014 business’ prospect.**

Quarter 4 is usually off-season stay of domestic demand due to rainy season, thus, company will balance its sales’ strategy through pushing exports. In parallel with diversifying local sales’ points through new outlets, we expect sales’ speed of HSG will be maintained, estimated sales volume is about 242,000 tons, increases slightly compared to Q3. Meanwhile, average selling price may not change much because there is still high finished goods’ stock level in the warehouse. In general, we do not expect much about the last quarter’ business result, estimated revenue for the FY2013-14 is about VND15,415 bn (+31%yoy) and net income about VND399 bn, a year-on-year decline of roughly 31%, an equivalent to only 66.5% its full-year profit target.

**Exhibit 3: Quarter 4 and FY2013-2014 Forecast**

Particulars (VND bn)	Q4- FY13/14 E	2014 Plan	2014E	+/- yoy
Net Revenues	4,448.6	14,000	15,414.6	31.1%
Gross profits	533.9		1,778.6	4.2%
EBIT	170.2		674.9	20.3%
PAT	117.3	600	398.7	-31.4%

Sources: HSG, RongViet Securities

Though, we expect the Company could gain better results in the next fiscal year after the new cold rolling line is put into operation. In addition, the downtrend of HRC price has been steadied recently which also is considered to be a positive factor for the Company.

**Outlook and valuation**

HSG is pursuing a blitz strategy in its investments in order to take advantage of economies of scale. In comparison with its peers, HSG has cutting-edge technologies and has been quite successful in establishing itself as a prestigious brand. Those, in combination with a wide distribution network are the reasons why we think HSG will succeed in increasing sales volume and revenue. Nonetheless, expanding production scale and markets are not easy tasks. For instance, the Company has had to sacrifice a portion of its profit margins to push sales in the context of high material price volatility. Moreover, the increase of the debt burden makes the impact of financial expenses on net income increasingly concerning. In FY2013-14, we forecast that HSG's sale volume will continue to increase such that revenue will reach about VND15,415 bn (+31% yoy) and net profit about VND399 bn (-38% yoy), translating to EPS of VND4,140.

Based on relative valuation, we think current market price of HSG has reflected reasonable company prospect for FY 2013-2014. However, with the brighter expectation for the next fiscal year, we suppose that investor could consider HSG as an investment opportunity if its gross margin shows a positive shift, especially in Q1 of FY2014-2015. Based on 3 valuation methods, i.e. the 5-year cash flow for the firm discount model (FCFF), the P/E approach and EV/EBITDA method, we estimate that the intrinsic per-share value of HSG is **VND48,100**. In comparing this with the closed price as of August 20, 2014, we rate the stock as **ACCUMULATE** in the **INTERMEDIATE** term.

Valuation method	Price	Weight	Average
FCFF	50,781	60%	30,468
EV/EBITDA	43,313	20%	8,663
P/E	45,204	20%	9,041
<b>Giá bình quân</b>		<b>100%</b>	<b>48,172</b>

	VND Billion			
INCOME STATEMENT	FY11/12	FY12/13	FY13/14E	FY14/15F
Revenue	10,088.0	11,759.9	15,414.6	17,869.8
COGS	8,682.8	10,052.4	13,636.0	15,538.8
<b>Gross profit</b>	<b>1,405.1</b>	<b>1,707.5</b>	<b>1,778.6</b>	<b>2,330.9</b>
Selling Expense	386.4	491.3	693.7	822.0
G&A Expense	261.2	350.5	400.8	500.4
Finance Income	48.6	39.7	34.0	44.6
Finance Expense	409.2	246.6	262.3	298.4
Other profits	14.7	20.3	60.0	30.0
<b>PBT</b>	<b>411.6</b>	<b>679.0</b>	<b>515.8</b>	<b>784.7</b>
Prov. of Tax	43.5	98.2	117.1	172.6
Minority's Interest	0.0	0.0	0.0	0.0
<b>PAT to Equity Shareholder</b>	<b>368.1</b>	<b>580.8</b>	<b>398.7</b>	<b>612.1</b>
EBIT	<b>751.9</b>	<b>846.9</b>	<b>674.9</b>	<b>967.8</b>
EBITDA	1,025.9	1,137.4	990.0	1,331.0

	%			
FINANCIAL RATIO	FY11/12	FY12/13	FY13/14E	FY14/15F
<b>Growth</b>				
Revenue	23.5%	16.6%	31.1%	15.9%
Operating Income	35.8%	14.3%	-21.0%	47.4%
EBITDA	172.5%	10.9%	-13.0%	34.5%
EBIT	346.3%	12.6%	-20.3%	43.4%
PAT	129.8%	57.8%	-31.4%	53.5%
Total Assets	-10.0%	34.2%	7.9%	4.7%
Equity	13.2%	9.5%	7.2%	15.2%
Internal growth rate	6.1%	15.6%	6.4%	14.1%
<b>Profitability</b>				
Gross profit/Revenue	13.9%	14.5%	11.5%	13.0%
Operating profit/ Revenue	7.5%	7.4%	4.4%	5.6%
EBITDA/ Revenue	10.2%	9.7%	6.4%	7.4%
EBITDA/ Revenue	7.5%	7.2%	4.4%	5.4%
Net margin	3.6%	4.9%	2.6%	3.4%
ROAA	6.6%	9.3%	5.4%	7.8%
ROIC or RONA	29.6%	31.1%	22.3%	28.4%
ROAE	19.4%	27.5%	17.4%	24.0%
<b>Efficiency</b>				
Receivable Turnover	14.5	15.6	19.2	19.3
Inventory Turnover	4.9	4.4	4.8	5.3
Payable Turnover	9.3	9.3	8.5	8.7
<b>Liquidity</b>				
Current	1.0	1.0	1.0	1.1
Quick	0.4	0.3	0.4	0.4
<b>Solvency</b>				
Total Debt/Equity	163.4%	222.9%	225.1%	195.4%
Current Debt/Equity	101.1%	127.3%	116.9%	94.8%
Long-term Debt/ Equity	30.0%	26.6%	37.2%	30.4%

	VND Billion			
BALANCE SHEET	FY11/12	FY12/13	FY13/14E	FY14/15F
Cash and equivalents	67.4	177.3	399.6	304.7
Short-term investment	4.0	0.0	0.0	0.0
Receivables	757.9	748.2	860.4	989.4
Inventories	1,539.8	3,019.6	2,648.1	3,212.8
Other current assets	236.9	269.8	503.4	453.0
<b>Total Current Asset</b>	<b>2,606.1</b>	<b>4,214.8</b>	<b>4,411.4</b>	<b>4,959.9</b>
Tangible Fixed Assets	2,199.5	2,235.7	2,410.7	2,538.5
Intangible Fixed Assets	240.3	234.5	230.8	227.1
Construction in Progress	26.0	197.1	390.0	100.0
Investment Property	0.0	0.0	0.0	0.0
Long-term Invest ment	59.5	59.5	53.1	53.1
Other long-term assets	191.6	200.6	208.6	185.3
<b>Long-term Asset</b>	<b>2,716.9</b>	<b>2,927.3</b>	<b>3,293.2</b>	<b>3,103.9</b>
<b>Total Asset</b>	<b>5,322.9</b>	<b>7,142.2</b>	<b>7,704.6</b>	<b>8,063.9</b>
Payables	495.0	1,390.9	1,500.0	1,709.3
Other current liabilities	152.9	128.9	177.2	203.0
Current Debt	2,039.9	2,814.4	2,771.1	2,588.2
Long-term Debt	606.3	588.0	881.7	828.6
Other long-term liabilities	5.0	5.0	5.0	5.0
<b>Total Liability</b>	<b>3,299.2</b>	<b>4,927.3</b>	<b>5,334.9</b>	<b>5,334.0</b>
<b>Owner's Equity</b>	<b>2,018.5</b>	<b>2,210.4</b>	<b>2,369.7</b>	<b>2,729.8</b>
Capital	1,007.9	1,007.9	1,007.9	1,007.9
Retained Earnings	605.1	821.5	968.2	1,328.3
Funds & Reverses	10.7	10.5	23.1	23.1
<b>Others</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
<b>Total Equity</b>	<b>2,018.5</b>	<b>2,210.4</b>	<b>2,369.7</b>	<b>2,729.8</b>
Minority's Interest	0.0	0.0	0.0	0.0
<b>TOTAL RESOURCES</b>	<b>5,317.7</b>	<b>7,137.7</b>	<b>7,704.6</b>	<b>8,063.9</b>
CASH FLOW STATEMENT	FY11/12	FY12/13	FY13/14E	FY14/15F
<b>Profit before tax</b>	411.6	679.0	515.8	784.7
-Depreciation	274.0	290.6	315.0	363.2
<b>-Adjustments</b>	<b>338.0</b>	<b>171.6</b>	<b>0.0</b>	<b>0.0</b>
+/- Working capital	-571.2	-920.3	65.9	-581.0
<b>Net Operating CFs</b>	<b>452.3</b>	<b>220.9</b>	<b>896.7</b>	<b>567.0</b>
+/- Fixed Asset	-59.9	-485.0	-680.7	-174.0
+/- Deposit, equity investment	0.0	0.0	-0.2	0.0
Interest, dividend, cash profit received	3.9	5.9	0.0	0.0
<b>Net Investing CFs</b>	<b>-56.1</b>	<b>-479.1</b>	<b>-680.9</b>	<b>-174.0</b>
+/- Capital	-28.1	-24.3	0.0	0.0
+/- Debt	-330.9	735.1	250.4	-236.0
Dividend paid	-96.6	-337.8	-243.9	-252.0
<b>Net Financing CFs</b>	<b>-455.6</b>	<b>373.0</b>	<b>6.5</b>	<b>-488.0</b>
+/- cash & equivalents	-59.4	114.8	222.3	-95.0
<b>Beginning cash &amp; equivalents</b>	<b>128.4</b>	<b>67.4</b>	<b>177.3</b>	<b>399.6</b>
Impact of exchange rate	-1.6	-4.9	0.0	0.0
<b>Ending cash &amp; equivalents</b>	<b>67.4</b>	<b>177.3</b>	<b>399.6</b>	<b>304.7</b>

**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 which 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 \ Return Potential	BUY	ACCUMULATE	NEUTRAL	REDUCE	SELL
Intermediate- term (up to 6 months)	>20%	10% to 20%	-5% to 10%	-15% to - 5%	<-15%
Long-term (over 6 months)	>30%	15% to 30%	-10% to 15%	-15% to -10%	<-15%

**ABOUT US**

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The **Analysis and Investment Advisory Department** of RongViet Securities provides research reports on the macro-economy, securities market and investment strategy along with industry and company reports and daily and weekly market reviews

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