SPARE PARTS

PREPARING TO RIDE THE WAVE OF MANUFACTURING AND EXPORT RECOVERY IN 2024

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RONG VIET SECURITIES

SPARE PARTS - PREPARING TO RIDE THE WAVE OF MANUFACTURING AND EXPORT RECOVERY IN 2024

Investment Rating

Negative | Neutral | Positive

In 2024, we expect demand for truck and bus replacement (TBR) tires will surge, correlating with heightened road transportation of goods. This upturn is driven by increased activity in industrial manufacturing and import-export sectors. Furthermore, Vietnamese TBR tire exports are poised for growth in the US market, as Thailand, the current leading tire exporter to the US, faces impending anti-dumping duties imposed from Q2-2024. However, the rapid surge in share price based on those prospects, has not yet been fully supported by actual business results, leading to a limited upside potential for the stocks.

Export demand will play a key role in revenue growth in 2024 while difficulties tend to decline in the domestic markets

- Domestic consumption in 2024 could be supported by industrial production and transportation, which have become more active recently with road transportation of goods since October increasing significantly compared to the average of 9M-2023.
- Export demand likely surge in context of increasing road-based goods transportation in some main market: US, Brazil, EU. In addition, Vietnamese radial TBR tire corporates likely enhance their market share in US market (the largest global tire importer), benefiting from the favorable news which Thailand (top one tire exporter in the US market) faces significant risk of anti-dumping duties imposed.

Tire companies' gross margins can be hampered as natural rubber prices are moving in up trends

- Prices of sythentic rubber, carbon black will fluctuate in a narrow range around the price level at 2023-end because of the stable brent oil prices of USD 83-84/barrel. Meanwhile, the weather-induced supply constraints in main producers (SEA countries) along with the uptrends of automotive demand and tire export in China (accounts for 39.5% of natural rubber consumption in global), which supports this material price at a high level.
- We think domestic tire companies will increase the natural rubber inventory reservation or level up its selling price to partly offset the upward shifts from this materials.

Limited production capacity hinders long-term revenue and profit growth of domestic tire manufacturers

- The 4-wheel vehicle tire market size is enormous both globally and domestically. Due to its tiny scale, however, Vietnamese tyre manufacuters have to follow the selling price set by the FDI corporates and Chinese exporters. Hence, profit margin of domestic tire producers are easily hurt during the economic slowdown period. In addition, domesic tire producers (DRC, CSM, SRC) will face the limited sales growth in the long run once they reach the maximum capacity of production.
- Given the expectation that the economy will gradually recover from 2024, couple with the low inventory of Chinese goods, as well as the potential anti-dumping tax impused on Thailand tyres in the US market, we believe that VN manufacturers, who focus on quality enhancement and capacity expansion for radial export, will see their profit margin recover soon.

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Risks to our call

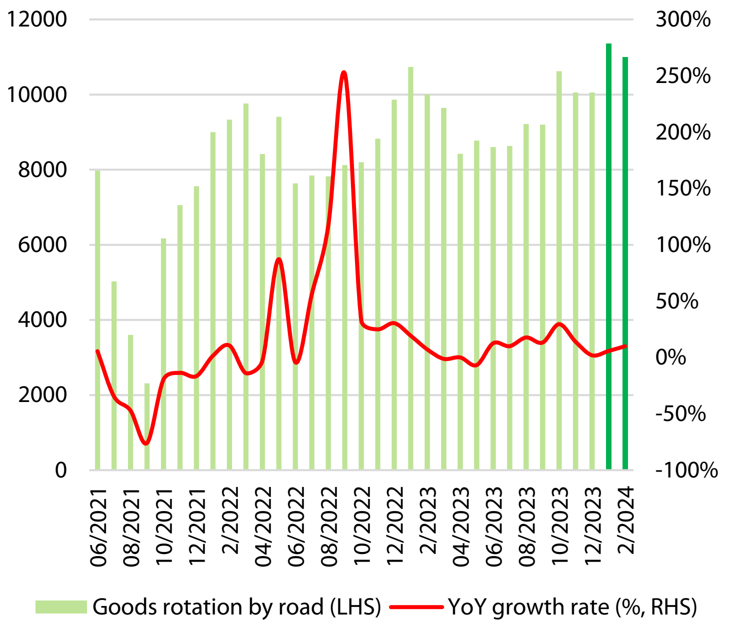
Downside risk

- Natural rubber price keeps staying higher than expectation, the bottom line of tire producers will be worse than our forecast;
- Vietnamese TBR tire export to US market is not favored from the US's applying anti-dumping tax (ADT) on Thailand tires as expected due to the increasing of US's importing from Cambodia's or Indonesia's instead of Vietnam's

We are optimistic about sales growth of TBR tire companies in 2024

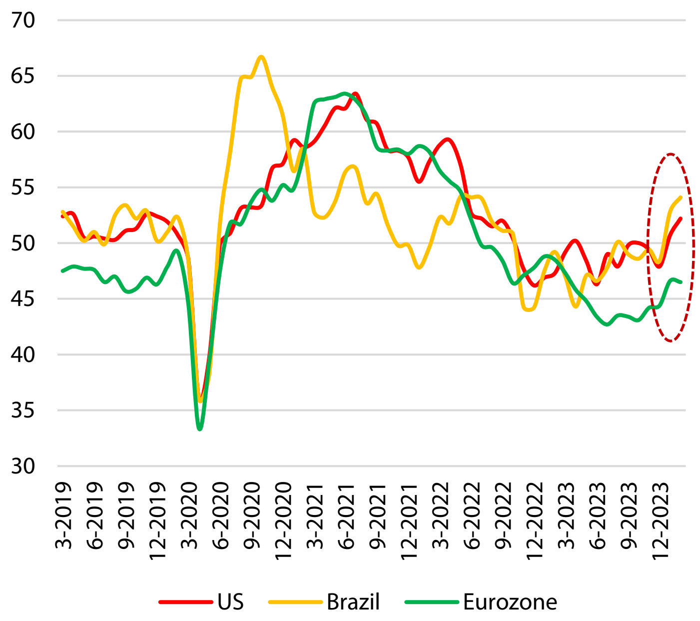
- We foresee a resurgence in industrial production and transporation, which will stimulate the road-based goods transportation in both domestic and global (Figure 1, 2). Consequently, we anticipate the two-digit growth for sales volume of TBR tires in 2024 from the low base of 2023. (Figure 3)
- Particular in the export value of Vietnam's TBR tire (mainly radial type), it also benefits from the precarious situation facing Thailand's tire exports, which are at high risk of being subjected to anti-dumping duties by the US ITC and DOC in H2-2024 (Table 1). Consequently, Vietnamese TBR tires are poised to serve as viable substitutes for Thai counterparts (Figures 4, 5).

Figure 1. Vietnam's monthly goods rotation by road (mn tons.km)



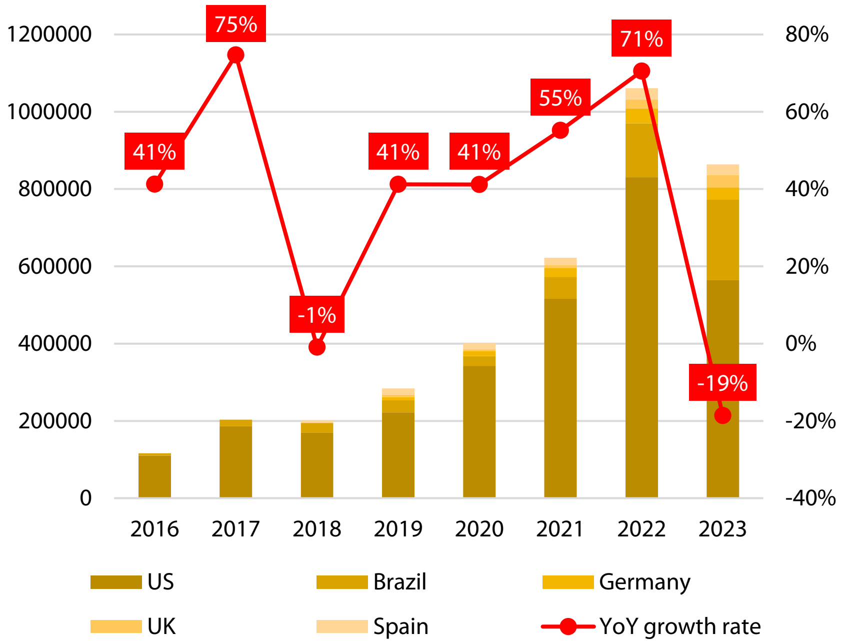
Source: VN GSO, RongViet Securities

Figure 2. PMI manufacturing in main export market of Vietnamese TBR tire



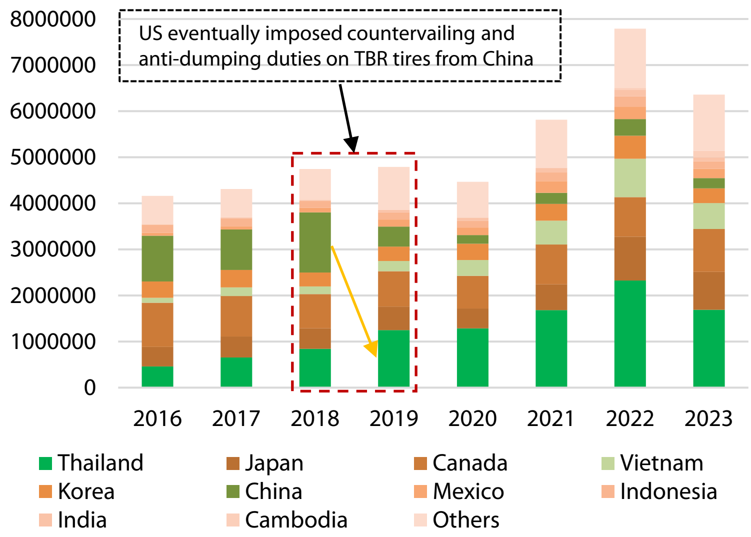
Source: Bloomberg, RongViet Securities

Figure 3. Yearly Vietnam's export value to its top-5 TBR tire market (USD thousand, LHS)



Source: Trademap, RongViet Securities

Figure 4. Yearly radial truck & bus tire's export value to the US by countries (USD thousand)



The US DOC's final decision on imposing anti-dumping duties on Thai TBR products is expected to apply from June-2024. As a result, Thai's TBR imports to the US are expected to decrease from Apr-2023, as orders normally take 45 days to reach the US.

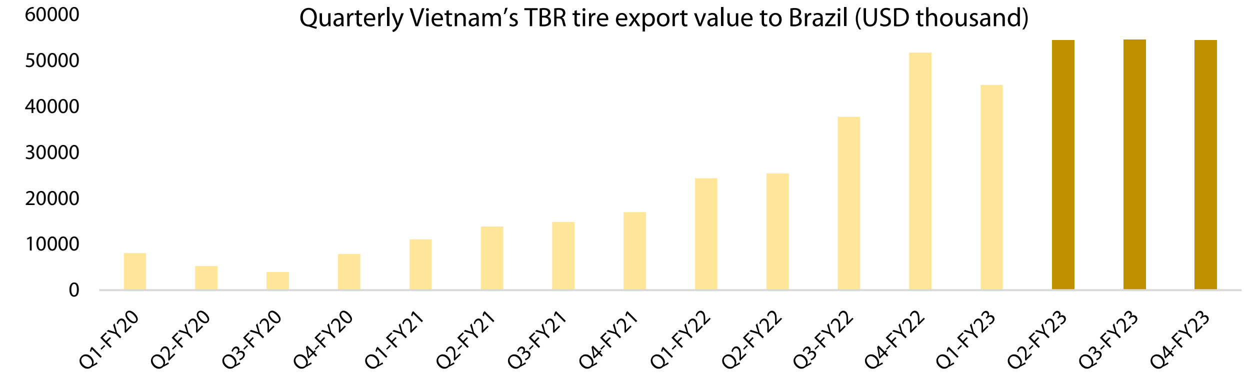
Source: Trademap, RongViet Securities

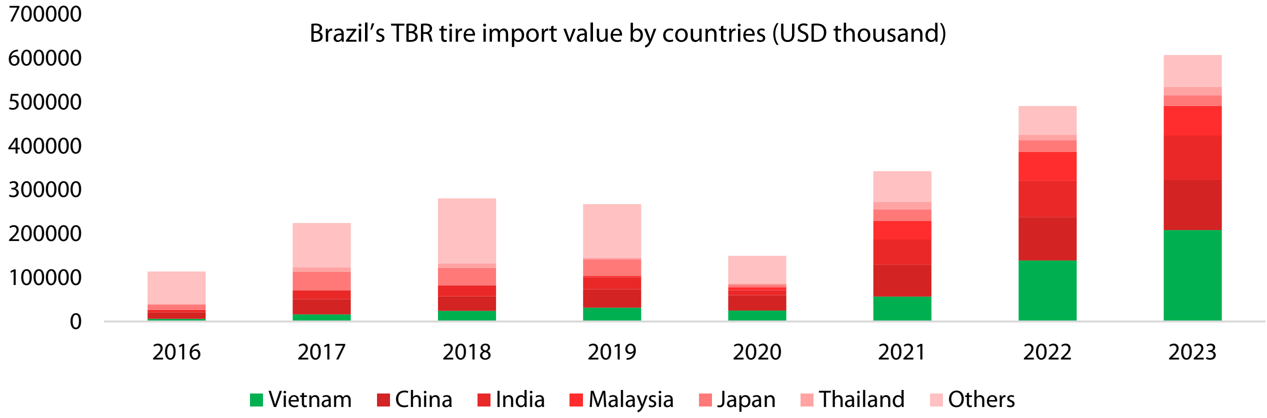
Table 1. Thailand's case calendar in US market

Event	AD INVESTIGATION
Petition Filed	October 17, 2023
Commerce Initiation Date	November 6, 2023
ITC Preliminary Determination	December 1, 2023
Commerce Preliminary Determination	March 25, 2024
Commerce Final Determination	June 10, 2024
ITC Final Determination	July 25, 2024
Issuance of Order	August 1, 2024

Source: US ITC, DOC, RongViet Securities

Figure 5. We predict Vietnam's TBR tire export value to Brazil, will be flat YoY due to maintaining its low price strategy.





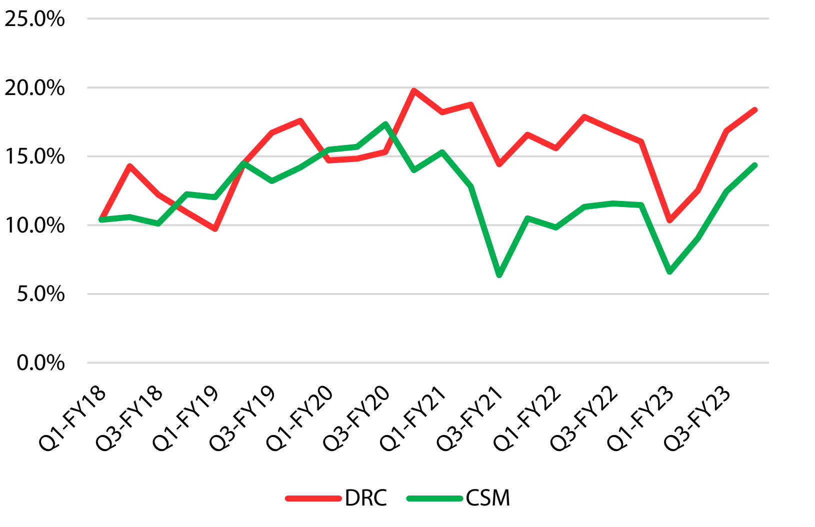
Vietnam's TBR tire export sales in Brazil stayed solid in H2-2023 with 109 USD mn (up 10% compared to H1-2023) despite being hit by Brazil's hike in import tax for cargo tires to 16% from 0% in late Mar-23.
It is explained that almost TBR tire manufacturers in Vietnam proactively cut their selling prices to share the higher input cost with Brazilian tire distributors/dealers (According to DRC, they dropped its selling prices in Brazilian market at 3 times lower before).

Source: Trademap, RongViet Securities

As natural rubber price tends to inch up, earnings will be hit in 2024

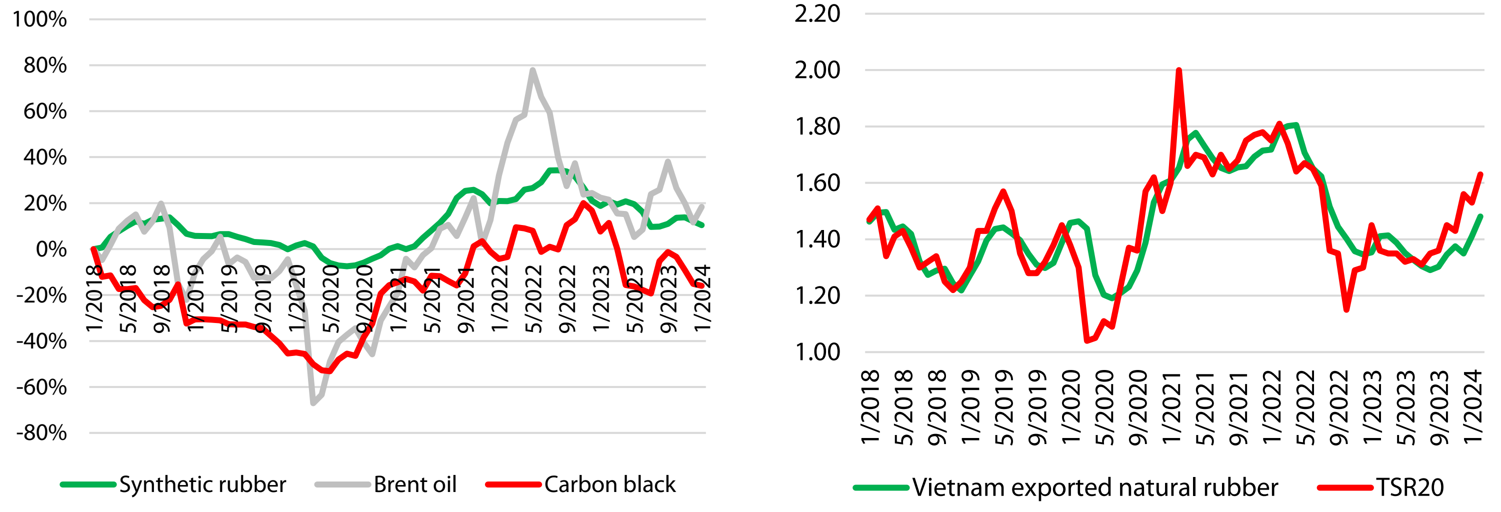
- On the back of favorable input prices, earnings of tire companies gradually recovered in Q2-4/2023 from the low level of Q1-2023 (Figure 6). However, the radip upswing of natural rubber from Sep-2023 will hamper its gross margin in 2024 (Figure 7), supported by weather-induced supply constraints in main producers (SEA countries) (Figure 8), (2) the uptrends of automotive demand and tire export in China (accounts for 39.5% of natural rubber consumption in global) (Figure 9, 10), (3) inventory levels were lower compared to those in 2021 and 2022 (Figure 11).
- Price of tire production's remaining components: sythentic rubber, carbon black (are made from oil) will fluctuate in a narrow range around the price level at 2023-end because of the stable brent oil prices of USD 83-84/barrel. (Figure 7)
- We suppose that tire companies will level up its natural rubber inventory reservation coupled with increasing the selling price in both domestic and export market to limit the negative impact of rising natural rubber in 2024.

Figure 6. TBR tire companies' gross margin (%)



Source: DRC, CSM, RongViet Securities

Figure 7. Materials' price movement

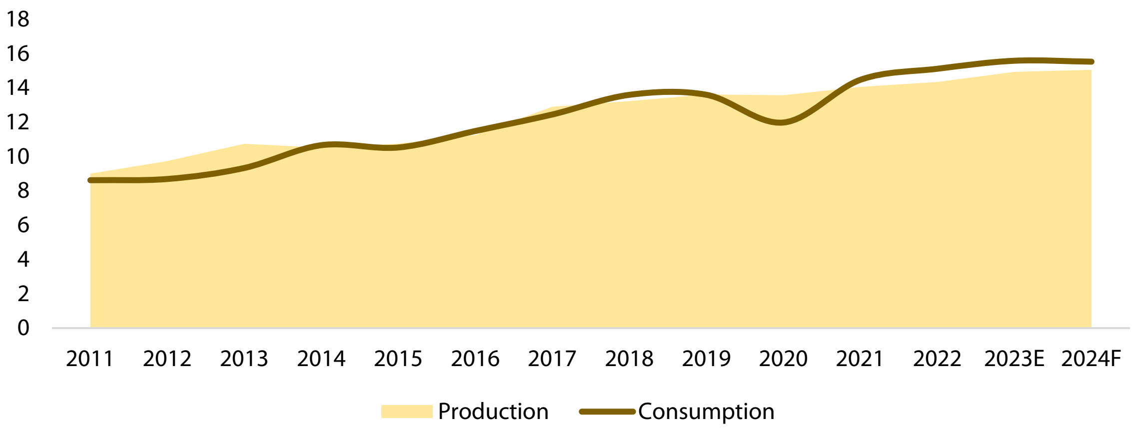


Source: Bloomberg, RongViet Securities

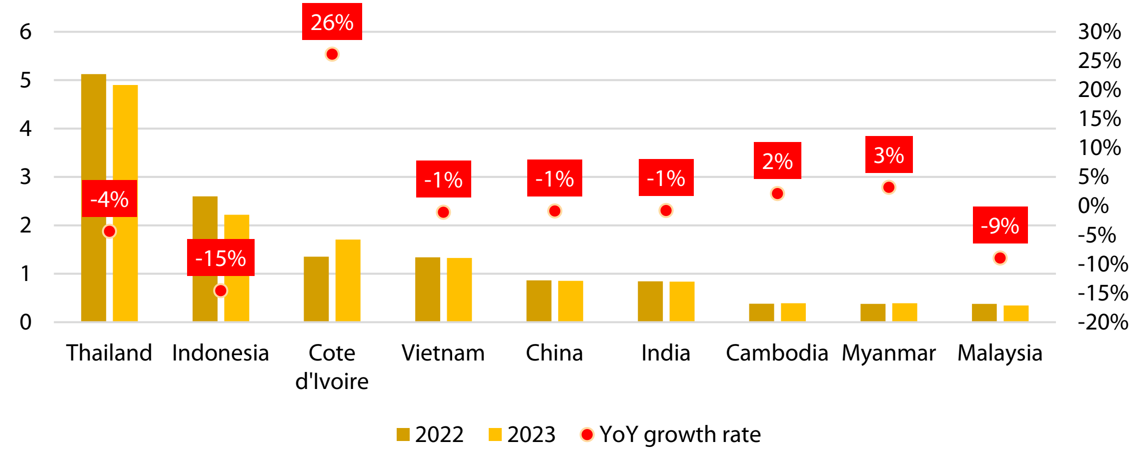
Source: Bloomberg, GSO, RongViet Securities

THE INCREASING OF NATURAL RUBBER PRICE CAN HAMPER THE GROSS MARGIN

Figure 8. Natural rubber supply will grow slowly because of adverse weather in some main producer (South East Asia countries)

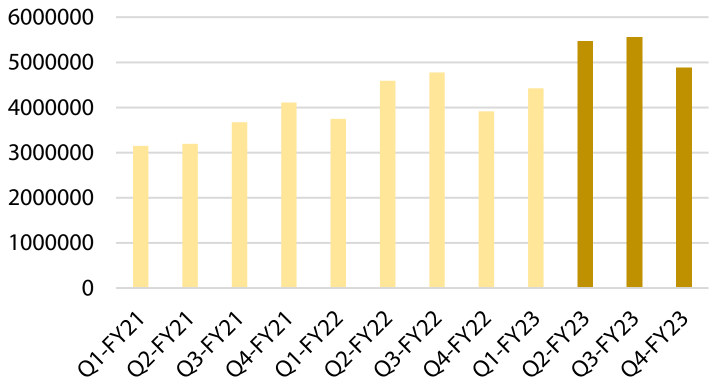


Source: ANRPC, IRSG, RongViet Securities



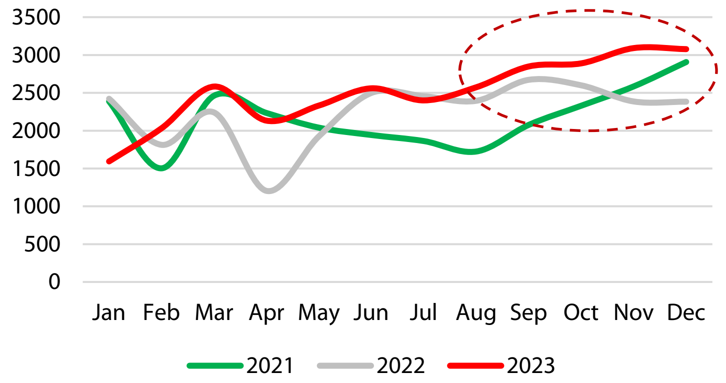
Source: ANRPC, RongViet Securities

Figure 9. Quarterly China export of rubber tires (USD thousand)



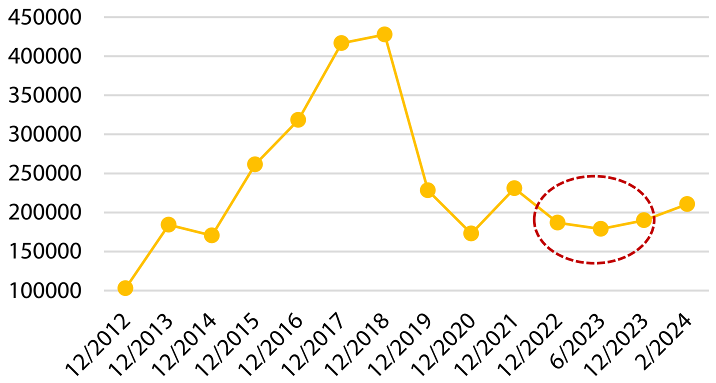
Source: Tradingeconomics, RongViet Securities

Figure 10. Monthly China automotive production (thousand units)



Source: MarkLines, RongViet Securities

Figure 11. China natural rubber's inventory level (tons)



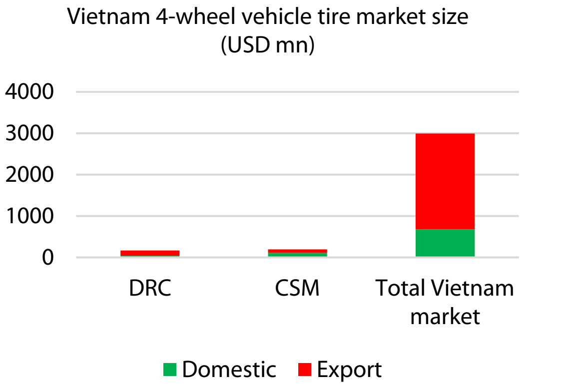
Source: SHFE, RongViet Securities

Table 2. Vietnamese tire manufacturers only strengthen in replacement tires with commercial vehicles (light/heavy truck, bus).

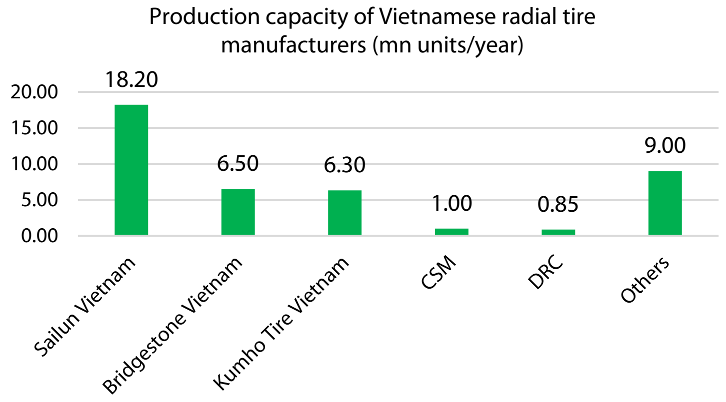
Manufacturer	Detail of product portfolio	Type of tire
DRC	DRC specializes in heavy/light truck and special tires, focusing on the Central region and specific corporate customers (THACO).	Replacement
CSM	CSM has the most diverse product portfolio, which includes tires for motorcycles, bus, and light trucks, with a primary focus on the Southern region.	Replacement
SRC	SRC has advantages in the bicycle and motorcycle tire segment and concentrates on the Northern region.	Replacement
FDI corporates (Bridgestone, Kumho,…)	FDI enterprises are manufacturers of radial tires for automobile/truck. Despite dominating the domestic market, these companies export the vast majority of their tires.	OEM/ Replacement

Source: RongViet Securities

Figure 12. Although the tire market size is enormous in both domestic and export market, Vietnamese tire manufacturers (DRC, CSM, SRC) cannot capture more market share due to its limitation in production level.

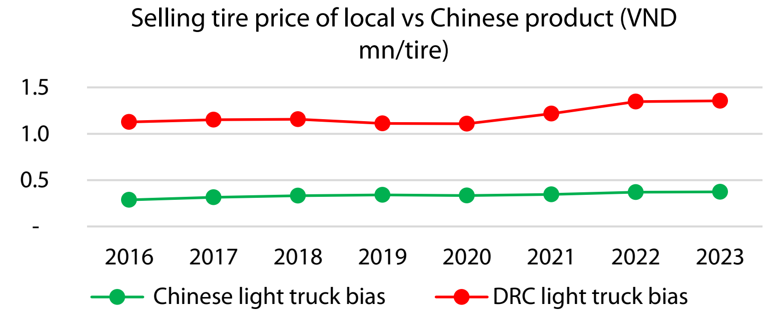


Source: DRC, CSM, VRA, RongViet Securities estimation



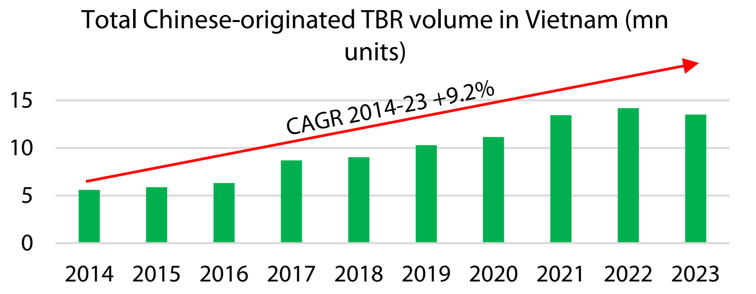
Source: TireBusiness, CSM, DRC, RongViet Securities

Figure 13. Furthermore, the influx of Chinese imports of TBR tires at competitive prices since 2019 poses a threat to the potential expansion of sales volumes for domestic tire companies.



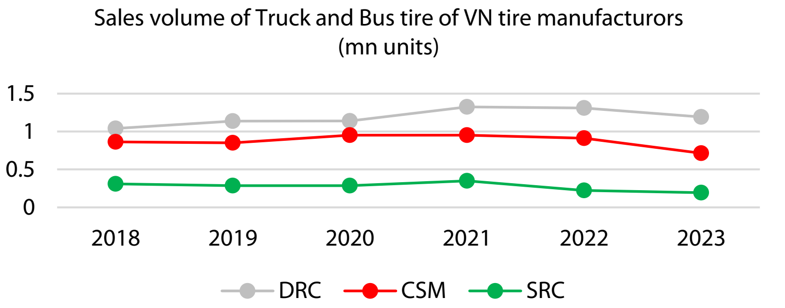
Note: The selling price visualized in chart regarding Chinese light truck bias is the custom price that is 35%-50% of the actual purchase price.

Source: Trademap, DRC, RongViet Securities



Due to being imposed countervailing and anti-dumping duties from US from 2019, the large amount of Chinese tires spill over to other Asian countries including Vietnam

Source: Trademap, RongViet Securities



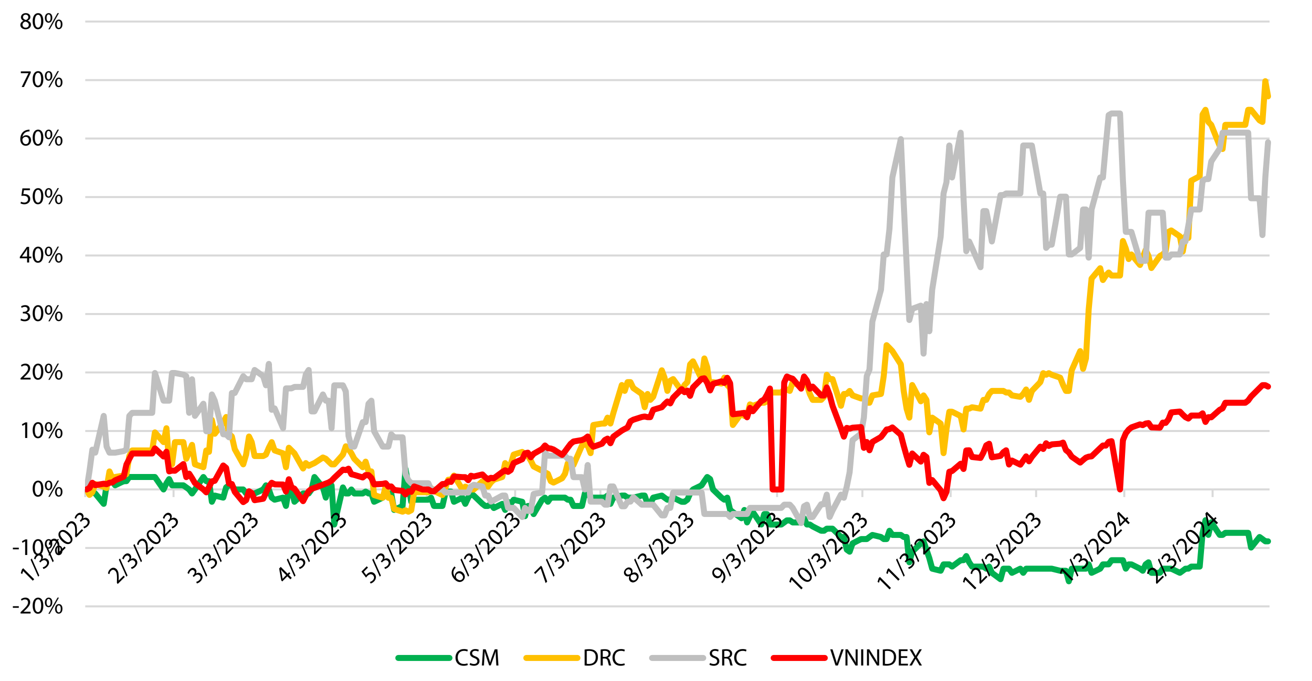
Sales volume of Truck and Bus tire (~2.5 mn units/year) of some VN tire manufacturers is much lower than China's (over 12 mn units/years)

Source: CSM, DRC, SRC, RongViet Securities

Stock price of listed tires manufacturers exhibited impressive performance during H2-2023

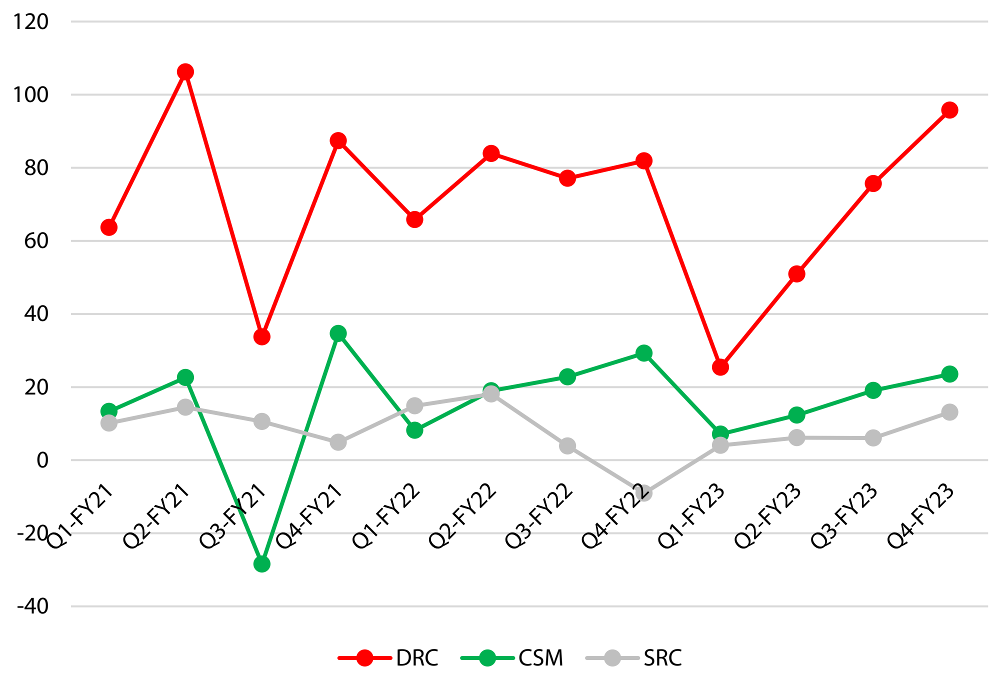
- The NPAT of tire companies hit a low point in Q1-2023 but gradually improved throughout the last three quarters of the year (Figure 15). It supported the uptrend of tire stocks in H2-2023. (Figure 14)
- Besides, the rally price of these stocks also reflected investors' optimism about 2024F positive earnings combining with the appealing story in each stock (DRC – the faster-than-expected progress in phase-3 of its radial factory, SRC – the increased ownership of major shareholder – Hoanh Son Holdings from 24.5% to 50.2% in Q4-2023). However, the rapid surge in share price based on those prospects, has not yet been fully supported by actual business results, leading to a limited upside potential for the stocks.

Figure 14. Stock price performance of tire sector (%, YTD)



Source: Bloomberg, RongViet Securities. Data as of Feb 22nd 2024

Figure 15. NPAT of Vietnamese tire manufacturers (VND bn)

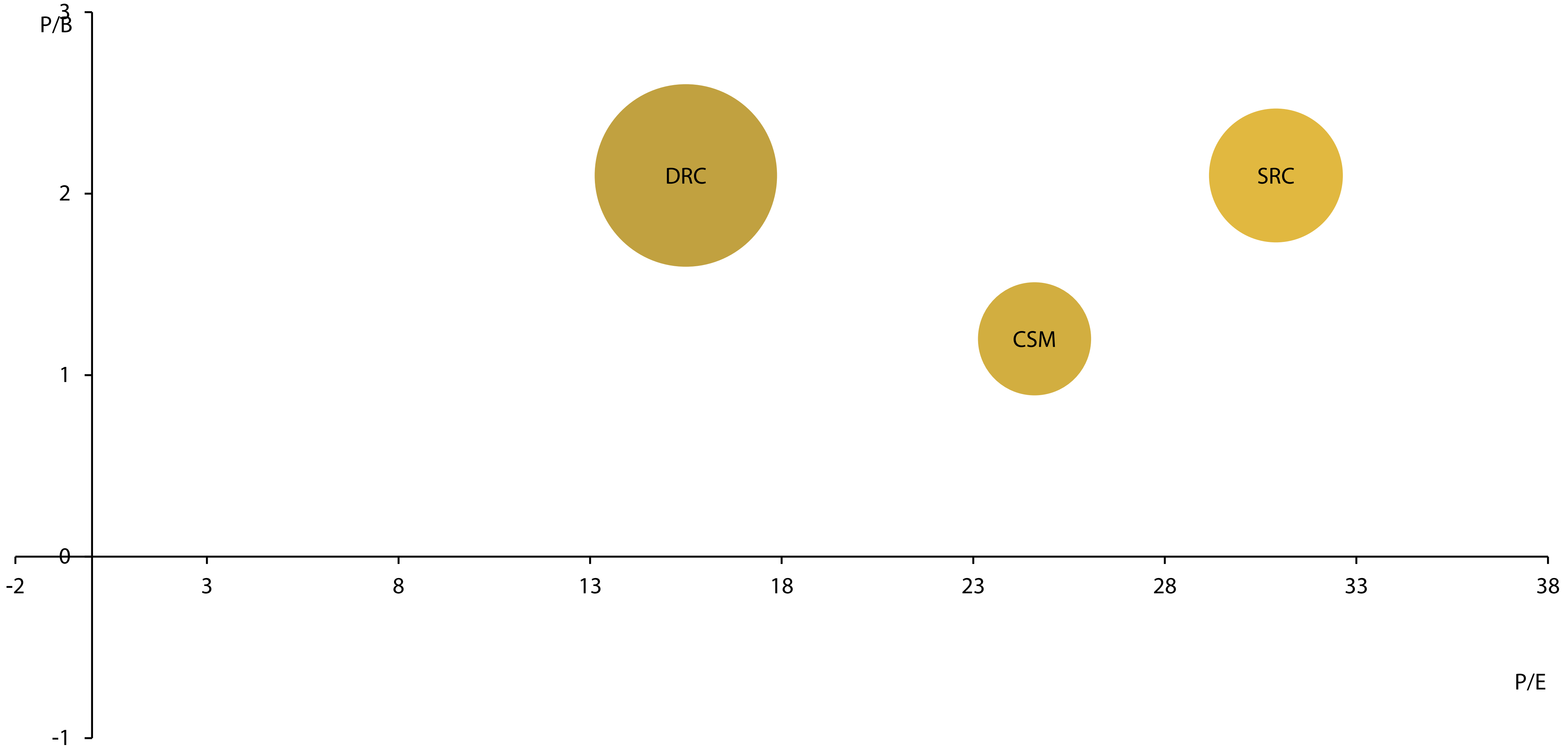


Source: FiinPro, RongViet Securities

Ticker	Market cap (USD Mn)	3m ave. matching order value (USD'k)	Cur. PER (x)	Cur. PBR (x)	4Q TTM ROE (%)	Target price (VND)	Market price (VND)	Expect return (%)	2023E			2024			Revenue growth (%)		NPAT growth (%)	
									Revenue (USD mn)	NPAT (USD mn)	EPS (VND)	Revenue (USD mn)	NPAT (USD mn)	EPS (VND)	2023E	2024F	2023E	2024F
CSM	55	12	21.2	1.0	4.7	n.a	15,850	n.a	219	2.6	598	n.a	n.a	n.a	-1.6	n.a	-21.7	n.a
DRC	161	651	16.9	2.1	13.4	28,800	34,100	-6.5	188	10.4	1,922	223	13.1	2,331	-8.2	19.0	-20.2	19.9
SRC	34	9	27.8	1.8	6.6	n.a	28,900	n.a	50	1.2	1,048	n.a	n.a	n.a	30.9	n.a	6.0	n.a

Source: Fiinpro, RongViet Securities. Share price as of 4th April 2024.

PE, PB AND ROE (TTM)



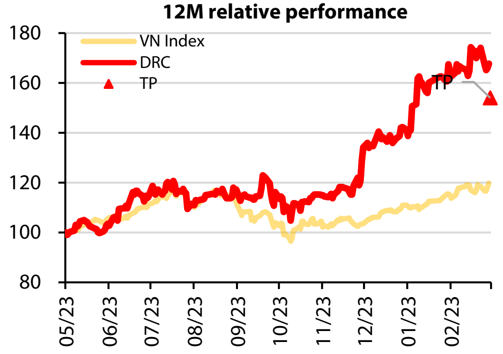
Source: Fiinpro, RongViet Securities. Bubble size equals respective ROE. Share price as of 20th Mar 2024. Excluding SGB and NVB due to outliers.

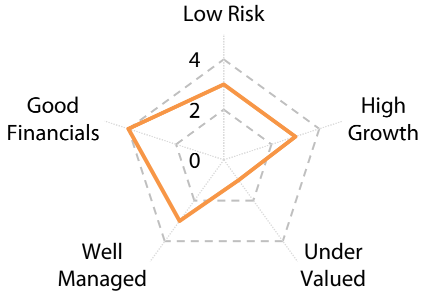
THE GROWTH PATH IS LESS BUMPY

HSX: DRC

NEUTRAL: -6.5% **MP: 34,100** **TP: 30,300**

12M relative performance





STOCK INFO

Sector	Spare Parts
Market Cap ($ mn)	155
Current Shares O/S (mn shares)	119
3M Avg. Volume (K)	1,218
3M Avg. Trading Value (VND Bn)	38
Remaining foreign room (%)	37.3
52-week range ('000 VND)	20 - 35.4

FINANCIALS

FINANCIALS	2023A	2024F	2025F
Revenue (VND bn)	4,495	5,349	6,004
NPATMI (VND bn)	246	295	352
ROA (%)	7.3	8.3	9.3
ROE (%)	13.3	15.6	17.3
EPS (VND)	1,908	2,331	2,785
Book Value (VND)	15,594	15,925	17,114
Cash dividend (VND)	1,800	1,500	1,500
P/E (x)	16.9	13.9	11.6
P/B (x)	2.1	2.0	1.9

INVESTMENT RATIONALES

Radial TBR tire maintains the riding role for DRC's performance in 2024F-25F

- We forecast DRC's radial sales volume to reach 25% YoY/15% YoY in 2024F-25F, respectively owing to (1) the improvement of global goods rotation, (2) the elevated capacity in its phase-3 radial factory from 0.75 to 1.0 mn units/year from Q2-2024, (3) the high probability of being a visible substitute for Thailand's TBR tire in US market in H2-2024.
- While competition have turned tougher in domestic, we are conservative in DRC's TBR bias tire sales volume forecast of 10% YoY/6% YoY in 2024F-25F from the low base of 2023.

Operating margin will maintain in a narrow range around the level at 2023 due to the rapid increasing of natural rubber

- In 2023, DRC hedged raw material price risks for 5 months in the end of Q4-2022, when input prices peaked, combining with the lowering output price, it hurted gross margin in overall 2023 inspite of the cooling of these prices from Q1-2023. Hence, the low base of 2023 coupled with our assumption that DRC will increase the natural rubber inventory reservation or level up its selling price to partly offset the upward shifts from this materials, its operating margin will grow by +6 bps YoY to 6.89% in 2024.

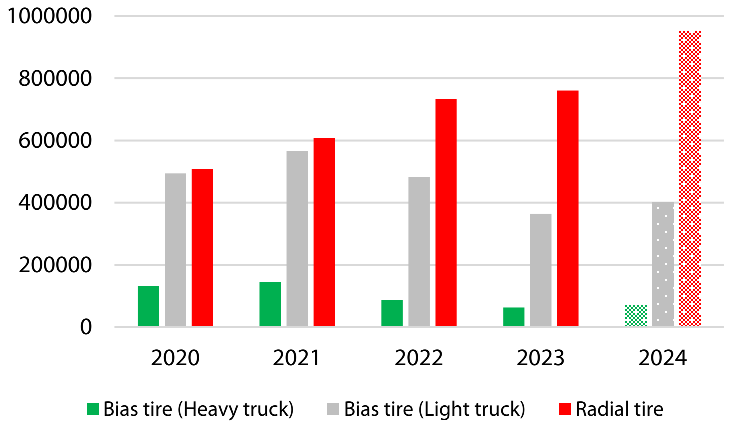
Current relative overvaluation (DRC's 2024F P/E of 13.9x vs average 2019-23 of 12.2x) is unlikely to leave a meaningful upside for DRC. Buy on price weakness is strongly recommended

A suitable investment under the "dividend investing strategy" with annual average dividend yield of over 5.5%

RISKS TO OUR CALL

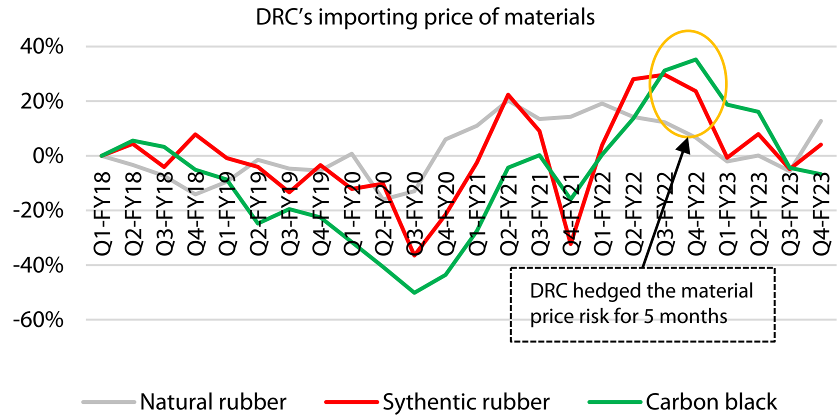
- Natural rubber price keeps staying higher than expectation, DRC's earnings will be hurt worse than our forecast.

Figure 1. Radial TBR tire maintains the riding role for DRC's performance in 2024 (units)

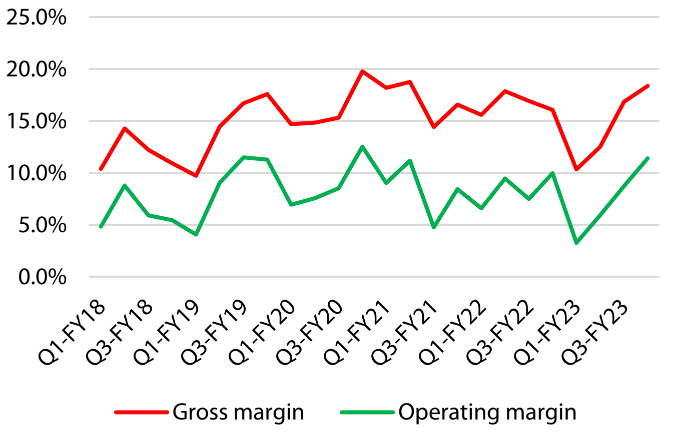


Source: DRC, RongViet Securities

Figure 2. We anticipate DRC's operating margin will improve by 6 bps due to the historic lows of 2023 coupled with our assumption that DRC will increase the natural rubber inventory reservation or level up its selling price to partly offset the upward shifts from this materials.

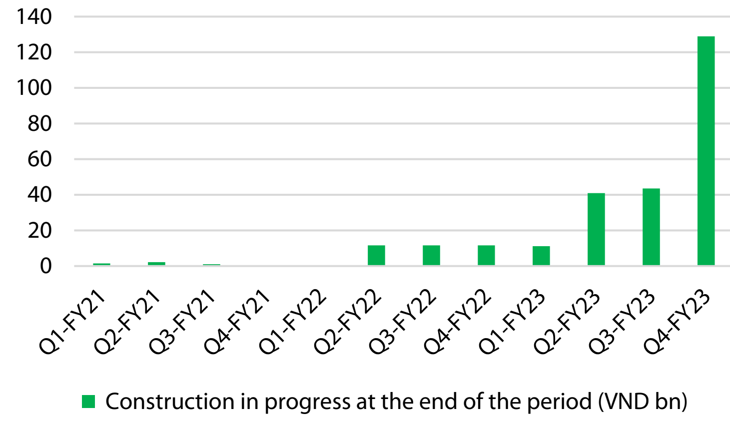


Source: DRC, RongViet Securities

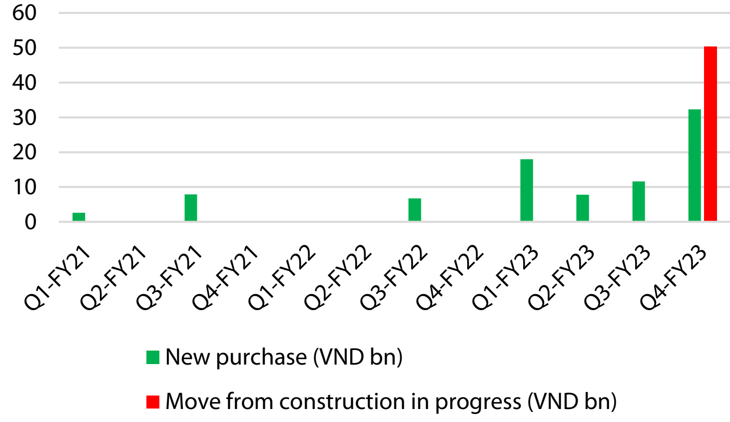


Source: DRC, RongViet Securities

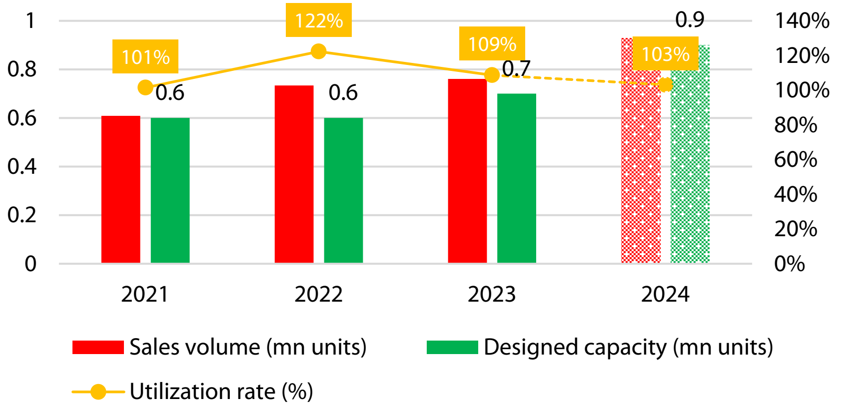
Figure 3. In H2-2023, DRC expedited the progress of its Radial-3 factory, predicting a gradual increase in capacity until the expansion is fully completed by Q2-2024



Source: DRC, RongViet Securities



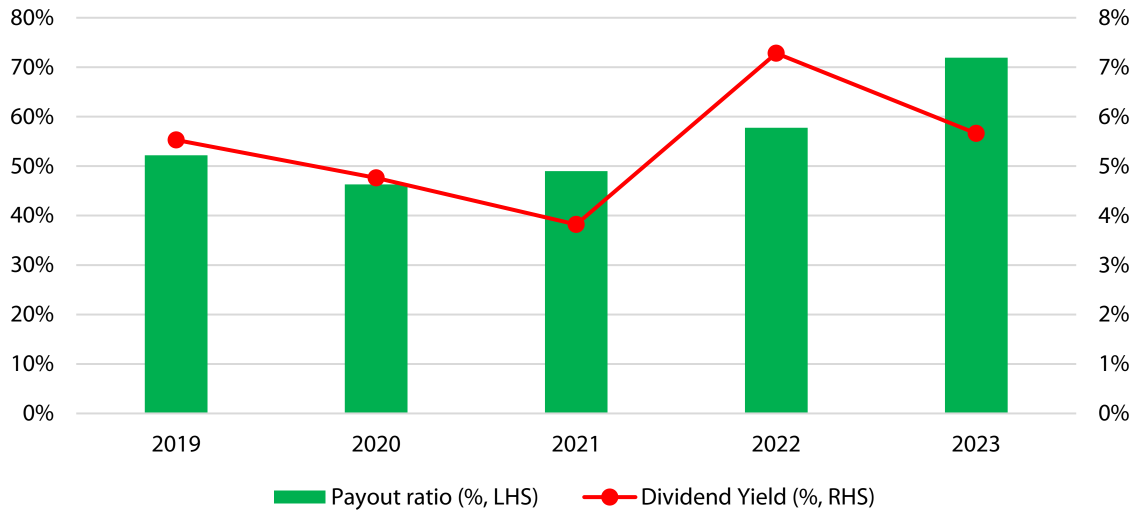
Source: DRC, RongViet Securities



Source: DRC, RongViet Securities

RAPID RISE IN SHARE PRICES LIMITS THE UPSIDE POTENTIAL

Figure 4. DRC may be an appropriate investment choice for those employing a "dividend investing strategy," given its consistent cash payout ratio policy of over 40% annually and an average annual dividend yield exceeding +5%.

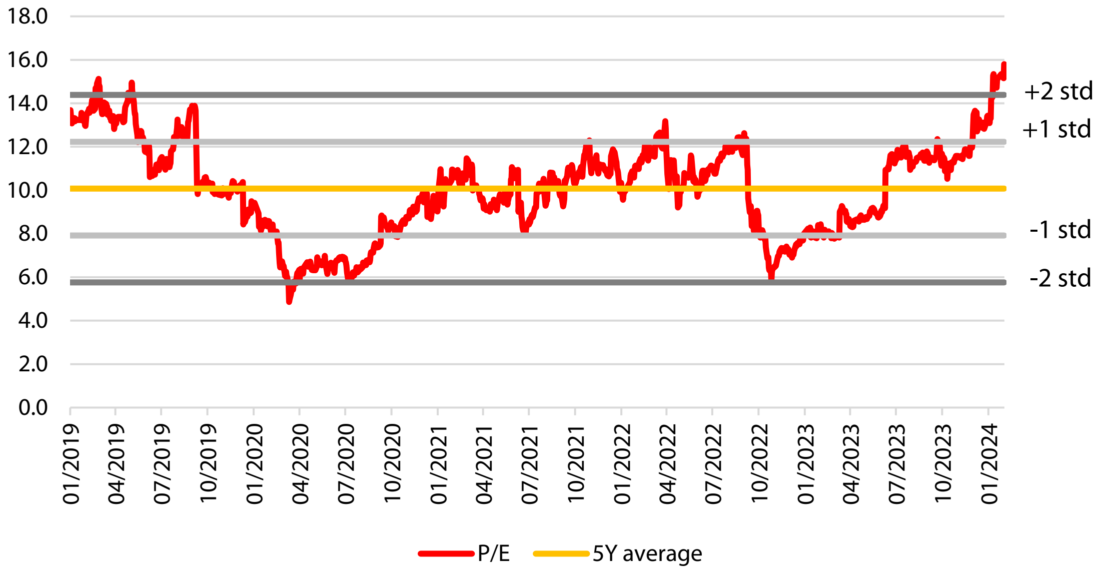


Source: Bloomberg, RongViet Securities

In Dec-2023, the stock price and P/E charts surged, mirroring the robust growth in profitability during Q4-2023 and investors' optimistic outlook for positive earnings in 2024. This optimism stems from the faster-than-expected progress of the Radial-3 factory and favorable news regarding the imposition of anti-dumping taxes on Thailand's cargo tires by the US Department of Commerce. This development is likely to support DRC's radial tire consumption in the significant US market.

However, current relative overvaluation (DRC's 2024F P/E of 13.9x vs average 2019-23 of 12.2x) is unlikely to leave a meaningful upside for DRC. Buy on price weakness is strongly recommended.

Figure 5. DRC's PE chart (x)



Source: Bloomberg, RongViet Securities

Table 1. DRC's valuation summary

Method	% Contribution	Value per share
5Y FCFF (WACC: 12.5%, g: 2.0%)	50%	32,662
P/E @ 12.5x 2024F EPS	50%	27,978
Target price (VND)	**100%**	**30,300**
12M expected cash dividend (VND)		1,500
Current market price (VND) (04/04/2024)		34,100
Total stock return		**-6.5%**
TP / 2024F EPS		13.0
TP / 2025F EPS		10.9

Source: RongViet Securities

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