SMC INVESTMENT TRADING JSC (HSX: SMC)

The worst is over and the turning point is coming

- **The steel industry has a sustainable potential to grow in the long-term**
- **SMC has advantages to take opportunities from the industry's growth**
- **New coil centers in Da Nang and a steel pipe factory are SMC's growth engines**

SMC has a strong competitive ability in the steel trading and manufacturing segments owing to its well-developed relationships with suppliers and customers, diversified products, and presence in key areas. We like its ability to balance the interest between parties and then, increase its selling volume. Hence, the company has been maintaining a high selling volume's growth rate, especially in the steel pipe segment.

Vietnam's steel consumption per capita was extremely low compared to other Asian countries over the 2000-2018 period. In the next 2-3 years, we believe that the steel industry will get benefits from large public investments in infrastructure. Moreover, *the demand for processed coils and steel pipes will be supported if Vietnam attracts large manufacturers, mainly from China. Vietnam is also an attractive destination to home appliance and electronics companies, who use coil services. New coil center in Da Nang and the expansion of a steel factory will be the foundation for growth..*

The main risk to our recommendation is the volatility of steel prices, especially hot-rolled coil (HRC). Due to the complex impact of COVID-19, the recovery in HRC prices could be slow.

*Using FCFF and multiple methods, we come up with a fair value of **VND 11,100** per share. In the next 12 months, SMC plans to pay a cash dividend of VND 1,000 per share. Hence, the total potential return is **16%** based on the closing price on July 30th, 2020. We have an **ACCUMULATE** recommendation for this stock.*

Key financial ratios

Y/E Dec (VND Bn)	FY2018	FY2019	FY2020E	FY2021F
Net revenue	16,466	16,836	14,850	16,645
Change	*30%*	*2%*	-11.8%	12.1%
PAT	172	92	92.6	176
Change	*-39%*	*-46.6%*	0.9%	90.1%
Net margin	1.0%	0.5%	0.6%	1.1%
ROA	3.4%	1.8%	1.7%	3.2%
ROE	13.7%	7.1%	5.9%	10.5%
EPS (VND)	2,814	1,596	1,502	2,855
Book value (VND)	22,717	21,026	25,675	27,529
Cash dividend (VND)	2,000	2,000	1,000	1,000
P/E (x)	11.1	21.8	7.3	3.9
P/BV (x)	1.5	1.6	0.4	0.4

Source: SMC, Rong Viet Securities.

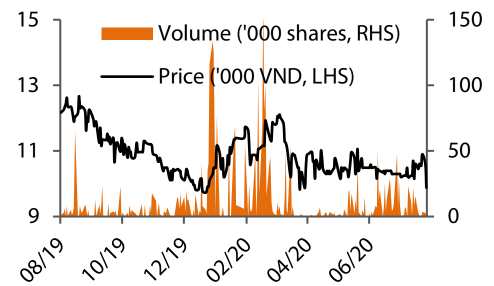
Note: Based on the closing price on July 30th, 2020.

ACCUMULATE +16%

Market price (VND)	10,400
Target price (VND)	11,100
Cash dividen in 12 months (VND)	*1,000*

Stock Info

Sector	Basic Materials
Market Cap (VND Bn)	630.6
Share O/S (Mn)	60.9
Beta	0.5
Free Float (%)	64
52 weeks high	12,669
52 weeks low	9,726
Average trading volume (20 sessions)	10,700



Performance (%)

	3M	1Y	2Y
SMC	-1.3	-15.6	-27.7
VN30 Index	3.6	-14.5	-21.0
VN-Index	3.8	-17.2	-16.3

Major shareholders (%)

Hanwa Company Limited	19.7
Nguyen Thi Ngoc Loan	14.3
Nguyen Cam Van	13.9
Remaining Foreign Room (%)	*15.9*

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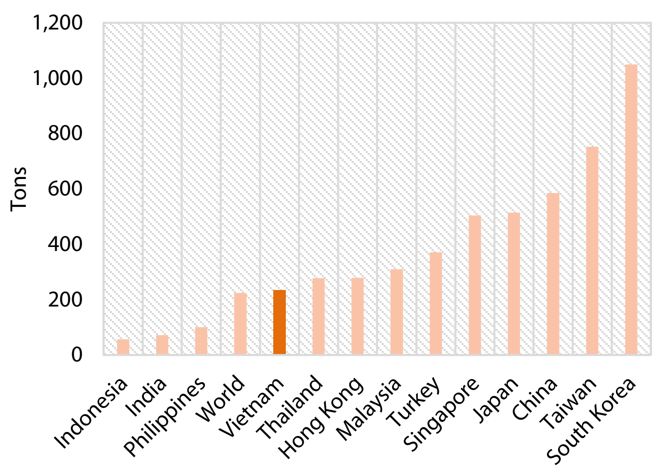
The steel industry has a sustainable potential to grow in the long-term

Vietnam's steel consumption per capita was extremely low compared to other countries in Asia over the 2000-2018 period

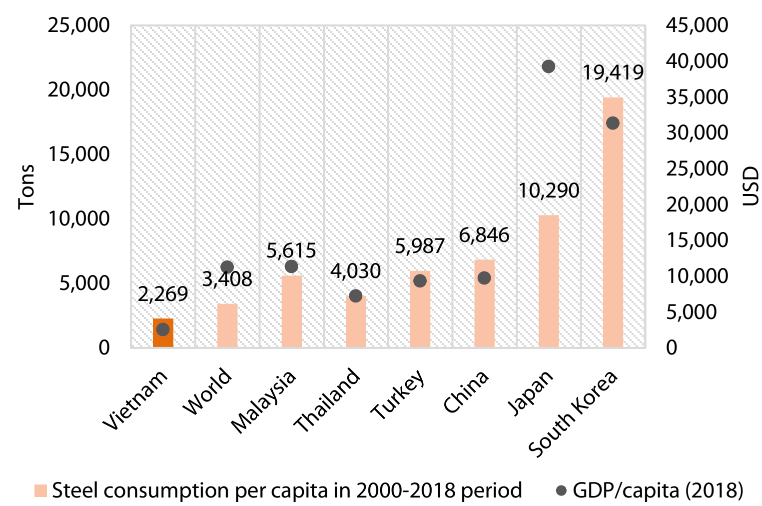
Although Vietnam started its infrastructure development period significantly later, the country is still consuming less steel per capita than Thailand and Malaysia. In 2018, a typical Vietnamese used roughly 234 tons of steel products, which was 15.5% lower than Thailand and 24.5% lower than Malaysia. Considering steel consumption in the 2000-2018 period, the gap between Vietnam and other countries in Asia was wide. In this period, Vietnam just consumed 2,270 tons of steel per person, which was just half the average of a Thai person's consumption. In our view, Vietnam's low consumption implied that its infrastructure and civil construction have not developed and there is a huge need for steel in the long-term.

Figure 1: Apparent steel use per capita (finished steel products) in 2018



Source: World Steel Association

Figure 2: Steel consumption per capita in the 2000-2018 period



Source: World Bank, World Steel Association

In the next 2-3 years, the steel industry will benefit from large public investments in infrastructure

The size of public investments in 2020 will be nearly VND 700 trillion, up roughly 200% YoY compared to the 2019's plan. 22% of the public investment budget will be spent in major transport projects, such as My Thuan 2 Bridge, My Thuan-Can Tho Expressway, eleven North-South Expressway sections. The construction of the My Thuan 2 Bridge to connect the southern provinces of Tien Giang and Vinh Long began in 1Q2020 at a cost of VND 5 trillion (USD 215.6 million) and will be completed by 2023. Meanwhile, My Thuan-Can Tho Expressway, which costs VND 4.92 trillion (USD 212.1 million), started in the first quarter and will finish by 2023. The four of eleven North-South Expressway sections will cost over VND 100 trillion (USD 4.31 billion).

We forecast that the steel consumption will be supported strongly by these projects from late-2020. These large projects will consume a significant amount of construction steel and steel pipes, especially the bridge projects.

The shift of manufacturers from China can boost the demand for steel pipes and coil processing services in Vietnam

We believe Vietnam can compete against other Asian countries to become a destination for many foreign manufacturers, who want to move their production lines, in part or whole, out of China. SMC would get benefits from selling steel pipes to build new factories and providing coil services to manufacturers, who produce automobiles, washing machines, refrigerators, etc.

The disruption in the global supply chain caused by the epidemic is urging businesses to diversify their manufacturing portfolios, as they are too dependent on one country. Companies need to focus more on the resilience of their production by building supply chains that can respond effectively to the unexpected disruptions. Hence, large manufacturers are planning to move a part of their production lines from China to other low-labor-cost countries, such as India, Indonesia, Vietnam, Thailand.

Vietnam has a strong competitive ability against other countries to attract foreign investors

Vietnam's ability to control COVID-19 is a bonus for foreign investors. The country has responded effectively to the virus by taking early actions and implementing drastic measures, which many other countries did not do. Vietnam has fewer than 300 cases and has yet recorded no COVID-19-related death, compared to 3,000 cases in Thailand and 11,200 in Indonesia.

Vietnam also has signed many international trade deals and invested significantly in industrial infrastructure over the past decade. Currently, the country has 13 Free Trade Agreements (FTAs) in effect and is negotiating to sign another four FTAs, including an important FTA with the EU. Besides, Vietnam is a large and low-cost labor market with 57 million people participating in the labor force. Besides, 90 million people living in this country is an attractive market for home appliance and car manufacturers.

Vietnam is also located next to China, hence, the relocation and facility development costs will be more competitive. It also has proximity to China in terms of laws, policies, and people's customs. Lastly, according to the World Bank, Vietnam has a better logistic system compared to India and Indonesia as its logistic performance index ranked 39th out of 160 countries, while India's and Indonesia's ranked 44th and 46th respectively.

Table 1: Vietnam, India and Indonesia's logistic performance index

Country	LPI Rank	LPI Score	Infrastructure	Logistics competence	Customs
Vietnam	39th	3.27	3.01	3.40	2.95
India	44th	3.18	2.91	3.13	2.96
Indonesia	46th	3.15	2.89	3.10	2.67

Source: World Bank, Rong Viet Securities

Some home appliance and electronics manufacturers are planning to shift their production lines to Vietnam and the demand for industrial land remains strong

Recently, 15 out of 30 companies, who paid by Japan Government to shift production out of China, chose Vietnam to open new factories. Besides, Panasonic planned to shut down a large appliance factory outside Bangkok and consolidate production to a larger facility in Vietnam to reduce costs. Its plant in Vietnam is the company's largest refrigerators and washing machines factory in Southeast Asia and has excess capacity.

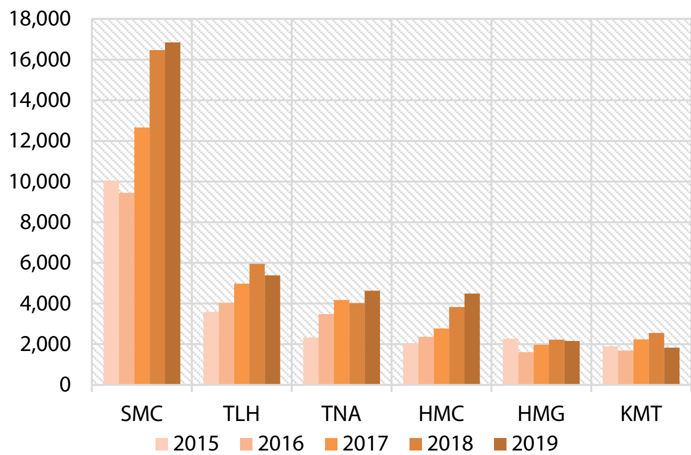
According to JLL, in 1Q2020, land prices in the Northern Industrial Market increased by 6.5% YoY to USD 99/m2 and are still rising. In the South, the rise was 12.2% to USD 101/m2. Despite the negative impact of COVID-19, the high demand for industrial land showed that Vietnam is an attractive destination for foreign manufacturers, who want to move part of their production lines away from China.

SMC has advantages to take opportunities from the steel industry's growth

All of SMC's segments can benefits from the steel industry's growth

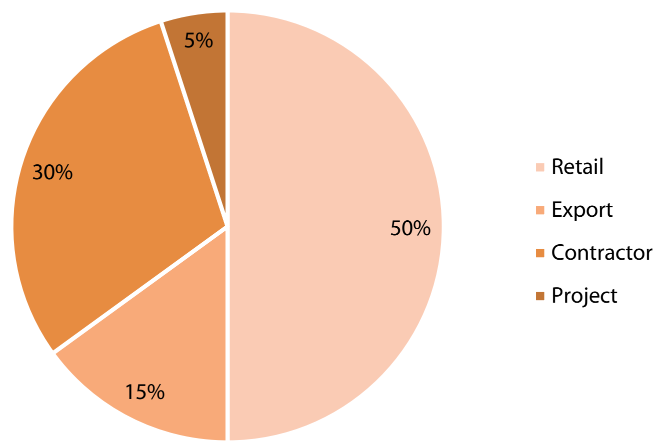
We expect that large investments in infrastructure projects will support SMC's trading segment. In 2019, selling volume to infrastructure projects accounted for 15-20% its total trading volume. The company provided steel products to large projects, such as the Tan Son Nhat airport expansion project, Long Thanh – Dau Giay Expressway, Ho Chi Minh City Metro, mainly through contractors. Regarding the steel pipe and coil processing segments, FDI inflow will boost both industrial construction, which uses steel pipe to build factories and warehouse, and demand for coil processing services, which is used in home appliance, automobile and machinery production.

Figure 3: Listed steel trading companies' revenue over last five years (VND billion)



Source: Surveyed companies' financial statements

Figure 4: SMC's trading volume, by sales channel



Source: SMC

The company has a strong competitive ability owing to well-developed relationships with suppliers and customers, diverse products, additional services, and presence in key areas

SMC has constantly maintained and developed relationships with major domestic steel manufacturers such as Vina Kyoei, Pomina, Southern Steel, Posco SS Vina, Hoa Phat, Formosa, and foreign steel producers, including Nippon Steel, Tata Steel., Hyundai, and China Steel Global Trading. SMC's closed relationships with suppliers allows it to have significantly higher trade payables compared to other trading companies and ensure a plentiful source of goods to meet the diverse requirements of many different customer groups. Besides, its ability to monitor steel prices in various markets allows the company to adjust its inventories and products' prices properly.

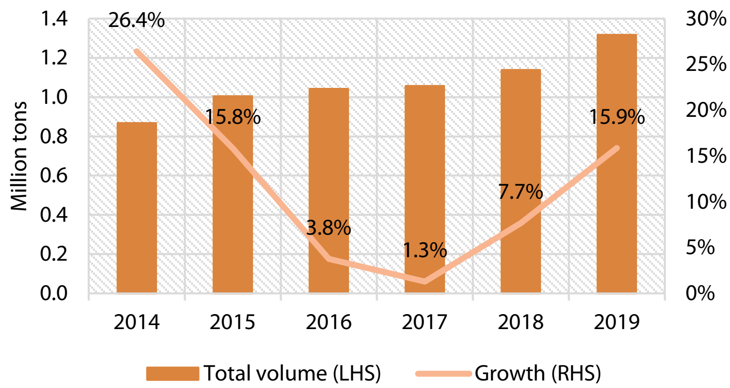
The company also has a diversified product portfolio and provides several valuable services to customers, such as coil processing and warehouse services. Owing to its relationship with many large domestic and foreign manufacturers, the company can offer products with different brands, quality, prices, and origins to meet customers' demand. The wide product range is one of SMC's key competitive advantages. Besides, after selling hot or cold rolled coil, SMC can offer to slit and cut coil service to customers, who want their goods as ready to use. These services help its customers to save on transportation costs and time.

Currently, SMC has six subsidiaries located in high growth and important cities and provinces, including Ho Chi Minh City, Ba Ria – Vung Tau, Da Nang, and Binh Duong. The company's subsidiaries in Ba Ria – Vung Tau and Da Nang, Vietnam's sea transport hubs, allow SMC to import and export steel products conveniently. Besides, the presence in Ho Chi Minh City and Binh Duong, Vietnam's most attractive destinations for foreign investors and main industrial hubs, help the company to keep a strong customer base.

Selling volume growth is recovering despite tough market conditions

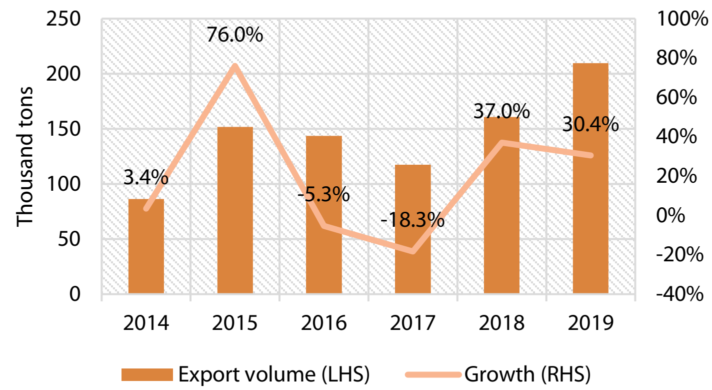
Although 2019 was a tough year for steel trading companies as construction steel and steel pipe consumption grew by just 6.0% and 0.3% YoY respectively, SMC showed its competitive ability by increasing selling volume at a significantly higher pace. The company's selling and export volume grew at 15.9% and 30.4% respectively in 2019. Over the 2015-2019 period, SMC maintained a high compounded annual growth rate in selling volume, especially export volume.

Figure 5: SMC's selling volume grew at a 8.7% CAGR



Source: SMC

Figure 6: SMC's export volume grew at a 19.4% CAGR



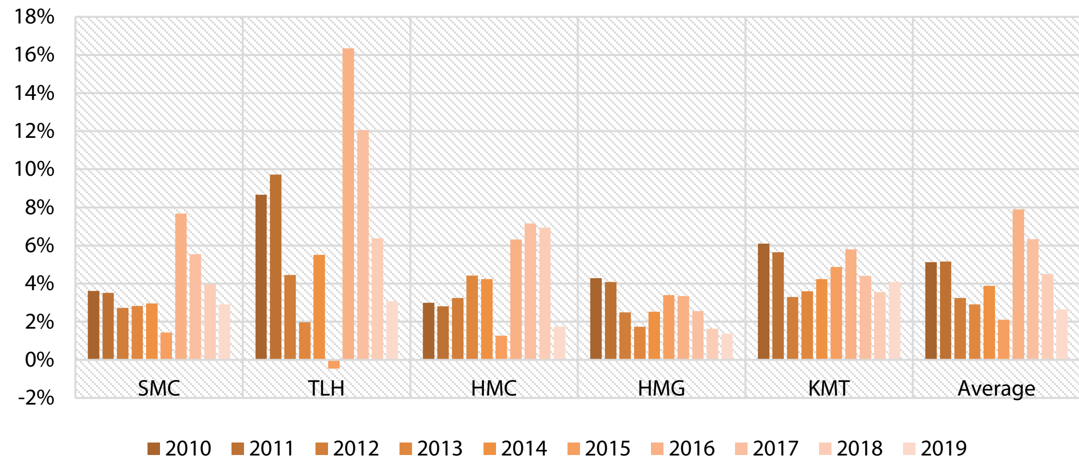
Source: SMC

Despite trading companies' profitability being volatile and low in tough market conditions, their important role of distributing products allow for acceptable profit

Steel trading companies' gross margin is volatile and depends on price movements. Over the last ten years, the average listed steel trading companies' gross margin varied from 2.1% to 7.9%. In 2015 and 2019, volatile and decreased HRC and rebar prices led to the segment's low gross margin of 2.1% and 2.6%, respectively, and many companies lost money. On the contrary, when steel prices went up as in 2016, the segment earned a significantly higher average gross margin of 7.9%.

In Vietnam, steel trading companies play an important role in distributing products to customers because most of the larger steel manufacturers, such as HPG, NKG, or Formosa Ha Tinh, do not have retail selling systems. Trading companies have a strong advantage to compete with manufacturers to distribute products owing to their diversified product portfolio, well-developed relationship with customers and manufacturers. Both manufacturers and retailers need steel trading companies to share market risks and working capital investment. However, due to low entry barriers, there are many small and medium trading companies in Vietnam, hence, the competition in the trading segment is high.

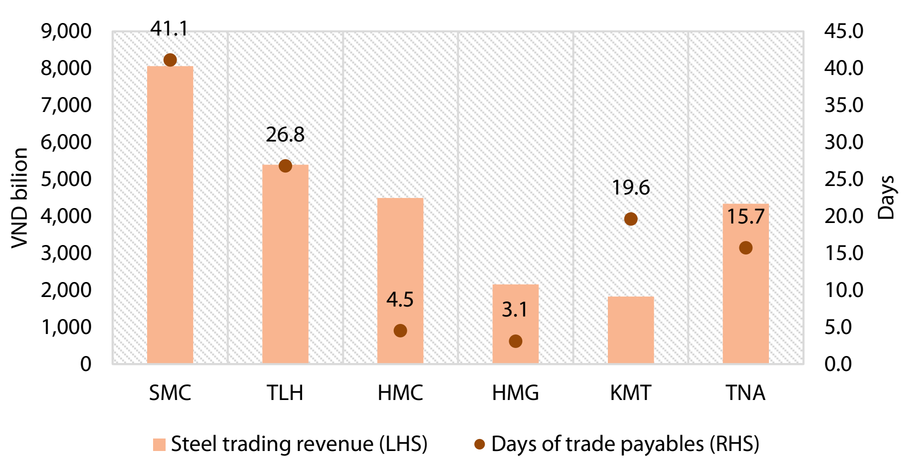
Figure 7: Listed steel trading companies' gross margin over the last ten years



Source: Surveyed companies' financial statements

In trading segment, SMC can maintain low working capital and equity. Compared to other steel trading companies, SMC has a strong reputation, which allows it to have higher trade payables. In 2019, its trade payable days were 41, while others' were significantly lower. Meanwhile, the company's inventory days were just under two weeks in tough market conditions. SMC's working capital was just VND -71 billion and VND -65 billion in 2018 and 2019, respectively. Due to the low working capital, its equity in this segment is also low, equivalent to 3.9% of its total equity.

Figure 8: Listed steel trading companies' days of trade payables



Source: Surveyed companies' financial statement

According to management, SMC can earn a gross profit margin of 2% - 3% without risks in transactions as long as the company matches customers' demand with manufacturers' supply immediately. Over the last ten years, SMC's SG&A expense was roughly 2% of net sales. Hence, it is an acceptable gross margin because its revenue is large, while its equity is low. If steel prices are stable, a low net margin of 0.2% will lead to a ROE of 31.0%.

New coil centers in Da Nang and steel pipe factory are SMC's growth engines

In March 2020, SMC's new coil center in Da Nang, which has a capacity of 50,000 tons per year, has run commercially and contributed 1-1.5 thousand tons per month to its processed coil volume. Besides, it also expanded steel pipe factory's capacity from 140,000 tons per year to 180,000 tons per year. In 2019, almost all SMC's factories ran at a utilization rate of 90-100%. This expansion will allow SMC to maintain its growth momentum in the next 2-3 years.

In the coil processing segment, the company has developed a good competitive ability. Firstly, it built a strong brand and had well-established relationship with customers and suppliers. After joining this segment in 2011, SMC has a wide customer base, including many large manufacturers, such as Daikin, Samsung Electronics, Thaco. Besides, the company also has closed relationships with suppliers, and even holds shares of several domestic steel manufacturers, including NKG, POM, TVN, TIS. Secondly, despite the high requirement of large customers, SMC is still a rarely domestic coil processing company who can supply coil services with high-quality standards. Finally, the company can manage material sources well, which must be imported from countries that have developed the steel industry.

The coil processing segment has low entry barrier, but it is not attractive to steel manufacturers. The initial investment to open a new coil center is relatively low. To build the new 50-thousand-ton-per-year coil center in Da Nang city, SMC just invested VND 100 billion. Thus, large manufacturers often have sufficient financial source to build a coil center for themselves and then, they can personalize products to meet their needs. For instance, Thaco has built a steel-processing factory in Chu Lai Complex. However, large steel manufacturers, such as HPG, NKG, HSG, have not joined this segment due to its low gross margin, varying between 4%-6%.

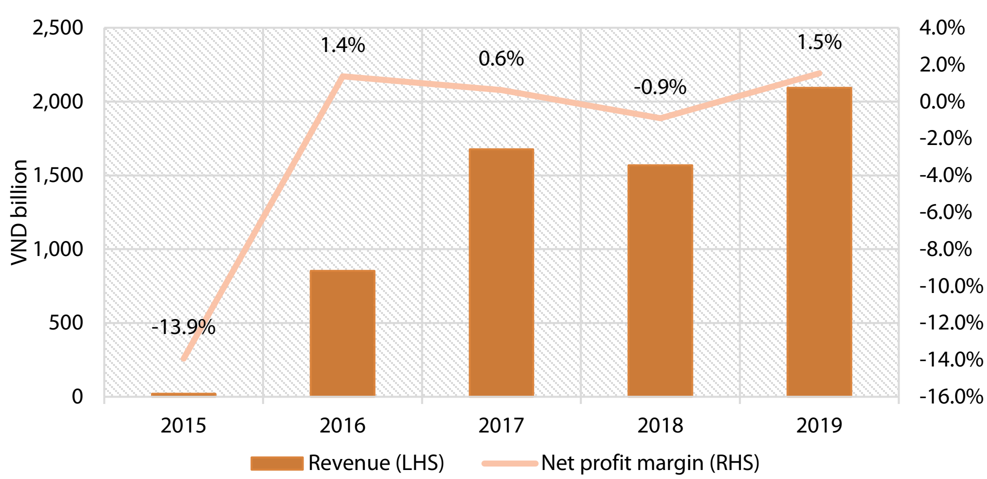
Steel pipe factory grew fast and has been more profitable due to its proper selling ability

After joining the steel pipe segment in 2015, SMC' selling volume has been growing at a high pace. Just in three years, from 2016-2019, the factory has run at a utilization rate of 100% and helped SMC to become the seventh-largest steel pipe producers in 2019. Owing to the available customer base in the trading segment, SMC took less time to understand customers' demand and market its products. Besides, SMC has excellent selling ability as it can negotiate flexibly to increase sales and balance interests between retailers and itself.

In 2019, although HRC prices fluctuated wildly, the steel pipe segment contributed VND 32 billion, which was equivalent to 32% of its total net income. After running this factory smoothly, SMC improved both its selling volume and profitability. SMC sold 141,000 tons in 2019, increasing by 25% YoY. The net margin also rose from -0.9% in 2018 to 1.5% in 2019.

This steel pipe factory's capacity was expanded from 140.000 tons to 180.000 tons per year in late-2019 and planned to reach 200.000 tons per year in late-2020. We expect the expansion in capacity to help SMC benefit from foreign manufacturers' shift to Vietnam.

Figure 9: Sendo steel pipe joint venture's revenue and net profit margin

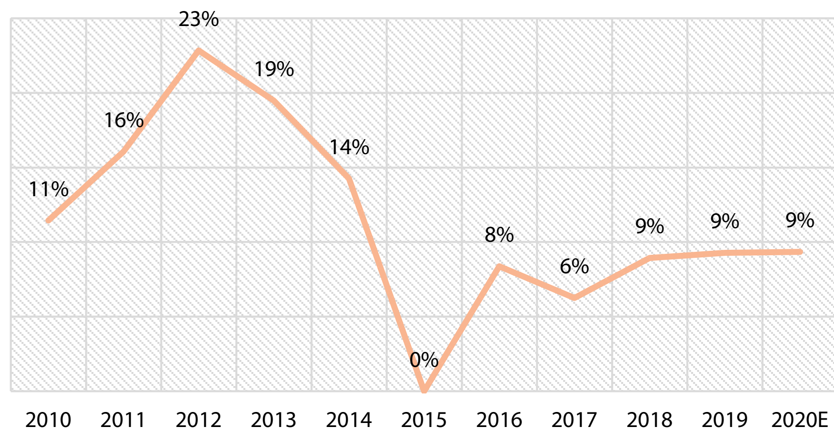


Source: SMC

SMC maintains an attractive dividend policy

Throughout the last decade, SMC kept paying a stable cash dividend. Except for 2015, when SMC posted a loss, the company paid a high cash dividend of roughly 10%. For 2020, it expects to pay a 10% dividend by cash, equivalent to a yield of 9.1%. In the steel industry, SMC is a rare company that paid a high cash dividend on a yearly basis.

Figure 10: SMC's dividend yield history

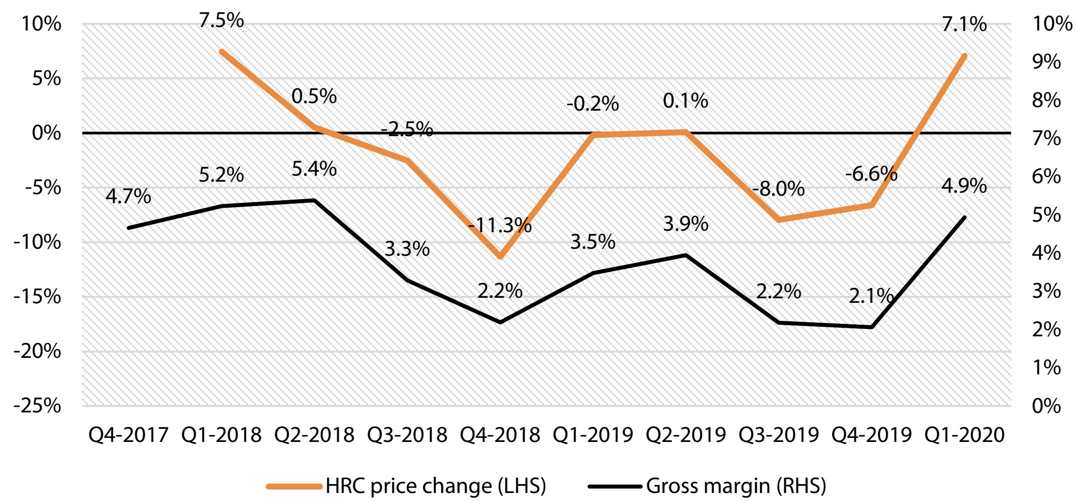


Source: SMC

RISK

Steel prices could fluctuate widely and be in a downtrend

Figure 11: HRC price change and SMC's gross margin



Source: SMC

SMC's gross margin is highly dependent on changes in steel prices. Most of SMC's segments, including coated steel, steel pipes, and coil processing, use the hot-rolled coil as input materials. After buying HRC, SMC faces the risk that HRC prices decrease, leading to lower finished product prices. SMC's gross margin is not dependent on HRC's price level but changes in HRC prices over its inventory period. Based on historical Vietnam's HRC CFR price and SMC's gross margin, we can confirm that SMC's gross margin tends to rise if HRC prices increase, and vice versa.

Foreign exchange rate risk

With an import volume of roughly 210 thousand tons in 2019, equivalent to 16% of selling volume, SMC has to borrow USD to pay foreign suppliers. Hence, exchange rate fluctuations may have a significant influence on SMC's performance.

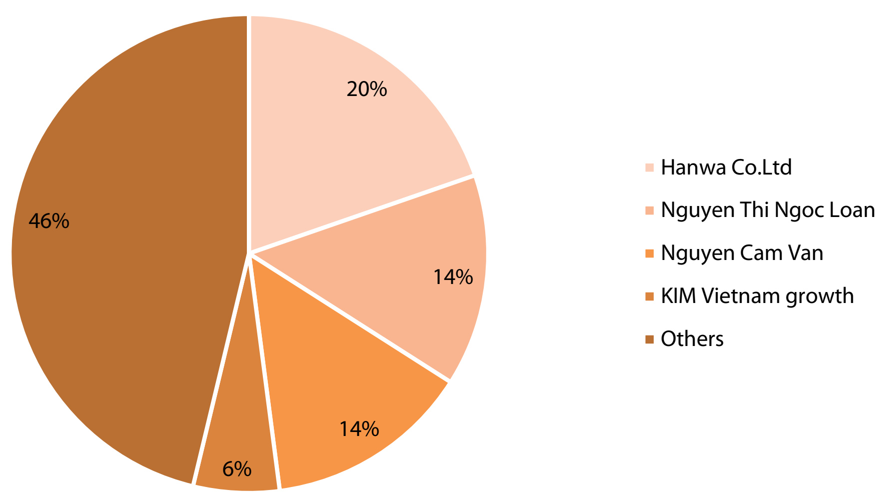
COMPANY OVERVIEW

SMC Joint Stock Company (HSX: SMC), previously known as the Construction Materials Store No. 15, was established in 1988. The company was equitized in 2004 and listed on the Ho Chi Minh Stock Exchange in 2006. In 2007, SMC began to expand its business into new segments, including coil processing, coated steel and steel pipe production. Currently, the company has three coil centers, one coated steel factory, one steel pipe factory and two joint ventures. Besides, SMC is by far the largest steel trading company listed on the stock market.

Shareholder structure

Currently, Hanwa Limited Company is SMC's largest shareholder with a 20% stake. Owing to this relationship, Hanwa helped SMC approach Japanese customers, such as Yamaha and Honda. The second-largest shareholder with a 14% ownership, Ms. Nguyen Thi Kim Loan, is SMC's Chairman. She is one of SMC's co-founders and has more than 20 years of experience as a leader in the company. Another important shareholder is Ms. Nguyen Cam Van, who has inherited shares from the late Chairman, Mr. Nguyen Ngoc Anh.

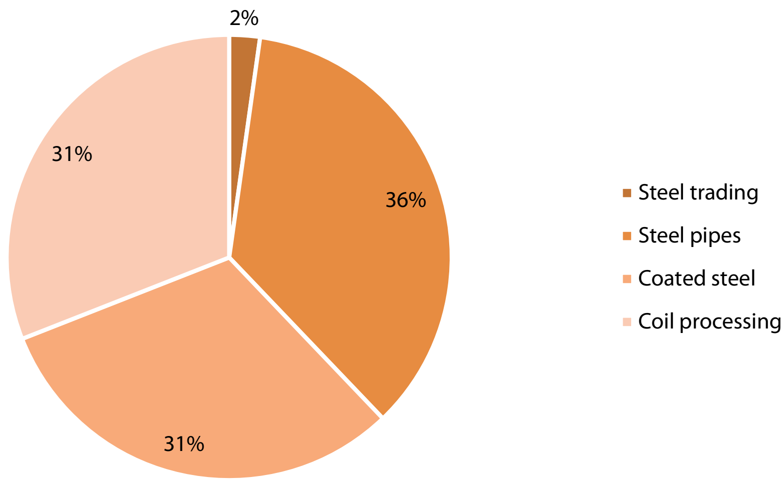
Figure 12: Shareholder structure



Source: SMC

Business overview

Figures 13: SMC's net income structure



Source: SMC

SMC's core business is separated into three segments:

(1) Steel trading: The company distributes many types of construction steel including wire rod, rebar, round steel and ribbed steel. Besides, it also trades steel sheets including hot rolled steel, cold-rolled steel, galvanized steel sheet. SMC's main domestic market is the South and its main export market is Cambodia.

(2) Coil processing: SMC's coil center system has a total processing capacity of more than 400,000 tons/year. Its factories located in Ba Ria-Vung Tau, Ho Chi Minh City, Da Nang, and Hanoi, are equipped with modern equipment imported from Taiwan (China). The company specializes in slitting and cutting types of coils, including hot rolled steel sheets, cold-rolled steel sheets, galvanized steel sheets, stainless steel, with a high standard of accuracy. Processed coils are used as outside panels in producing steel products, such as automobiles, washing machines, refrigerators, steel furniture, motorbikes, televisions, etc.

Figure 14: SMC's slitting and cutting lines in the coil processing segment

Source: SMC

(3) Manufacturing: SMC's key products are zinc-coated steel and steel pipes. In 2019, this segment contributed roughly 73% of SMC's net income. Currently, the company has one steel pipe factory and one coated steel factory, which are located in Ba Ria – Vung Tau Province.

Figures 15: SMC's products and services

Source: SMC

Table 2: SMC's factories

Factory	Completed year	Location	2020 capacity (tons/year)
Sendo steel pipe factory	2015	Ba Ria – Vung Tau province	180,000
Coated steel factory	2017	Ba Ria – Vung Tau province	300,000
Coil Center Phu My	2007	Ba Ria – Vung Tau province	250,000
Coil Center Tan Tao	2013	HCM City	100,000
Coil Center Da Nang	2020	Da Nang City	50,000

Source: SMC

Position in the industry

Steel trading: SMC is one of the largest steel trading companies in the South as it accounted for roughly 15% of steel consumption in this market in 2019. Currently, the company is also the largest distributor of Vinakyoei, which ranked second in the Southern market in terms of sales volume. Besides, SMC is Vietnam's main steel exporter as in 2019, it accounted for 13.7% of construction steel exports.

Owing to its subsidiaries located in key areas, such as Binh Duong and Ba Ria – Vung Tau, SMC is an important distributor to large steel manufacturers.

Coil processing: The company joined this segment in 2007 and now, became one of the most reliable domestic company as it is supplying coil service to large companies, such as Thaco, Samsung Electronics Vietnam, Daikin and Yamaha.

Manufacturing: SMC just entered the steel pipe segment in late-2015, but it has grown fast at a CAGR of 118% over the 2015-2019 period to become the seventh-largest manufacturer in Vietnam and the third largest one in the South, in term of sales volume.

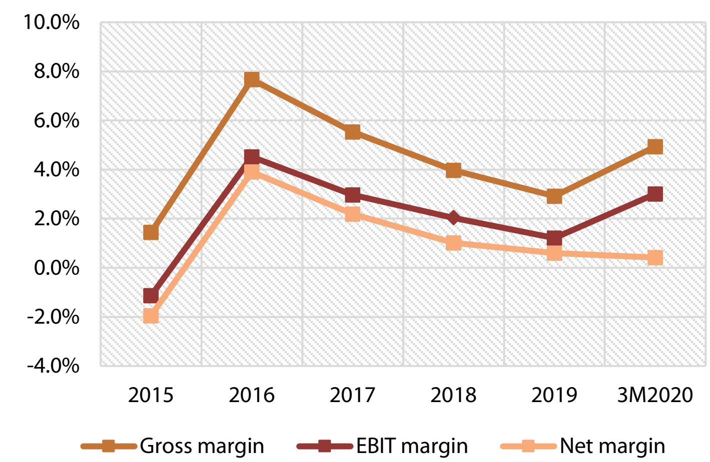
FINANCIAL ANALYSIS

Business efficiency depends on HRC's price movement

SMC's net income and profitability are highly reliant on HRC price' movements. The main reason is that the company often maintain enough HRC to use for roughly two months. Meanwhile, its selling prices change based on spot HRC prices. Therefore, its gross margin will be higher if HRC increase at a high pace.

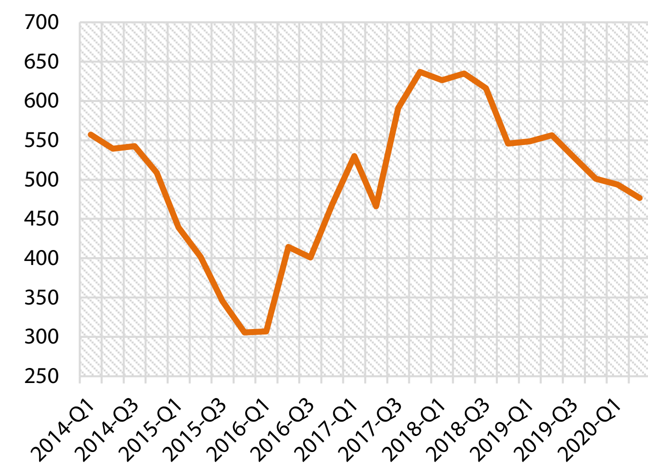
After hitting the bottom in 1Q2016, HRC prices recovered strongly, leading to the improvement in the company's margins and net income. In 2017, HRC prices still increased but at a slower pace than in 2016, hence, SMC's margins and net income decreased. Later, because HRC prices were in a downtrend from 2Q2018, the company's profitability fell steadily. Currently, HRC CFR Vietnam prices recovered to USD 440/ton in late-2Q2020 after hitting the bottom at USD 390/ton in late-1Q2020. We expect HRC prices to increase in late-2020 due to the recovery of the global economy after COVID-19. Therefore, SMC's profitability and net income will also improved strongly owing to the consolidation of inventory, which was bought at a low price.

Figure 16: SMC's margins



Source: SMC

Figure 17: HRC prices (USD/ton)



Source: Bloomberg

Table 3: Revenue, gross profit, and net income growth

	2015	2016	2017	2018	2019	3M2020
Revenue growth	-7.9%	-6.0%	34.0%	30.1%	2.2%	-17.0%
Gross profit growth	-55.2%	400.7%	-3.2%	-6.7%	-25.1%	17.9%
PAT growth	-1,057.0%	N/A	-25.0%	-39.2%	-40.6%	-59.3%

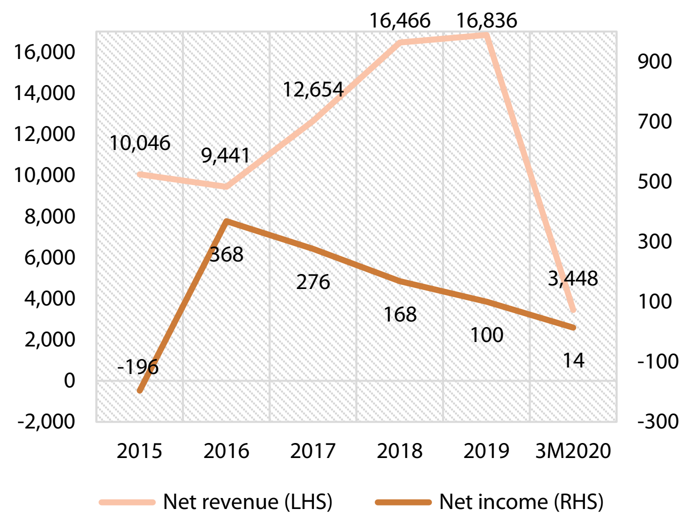
Source: VDSC estimates

Revenue grew continuously

Over the 2016-2019 period, SMC's revenue grew continuously due to steel prices and the capacity expansion. In 2016, SMC's revenue was just VND 9,441 billion, but it reached VND 16,836 billion in 2019, equivalent to a CAGR of 21.3%. In the 2016-2018 period, selling volume increased by just 9%, but steel prices increased strongly leading to a high revenue growth rate. In 2019, SMC's revenue rose slightly by 2.2% despite a drop of 11.7% in selling prices due to an increase of 15.8% in its selling volume, caused by the capacity expansion and a higher export volume. Its steel pipe capacity grew from 100 thousand to 140 thousand tons, and its coil centers' capacity increased from 350 thousand to 400 thousand tons. Although increasing its capacity, it maintained the steel pipe factory and coil centers' utilization rate at

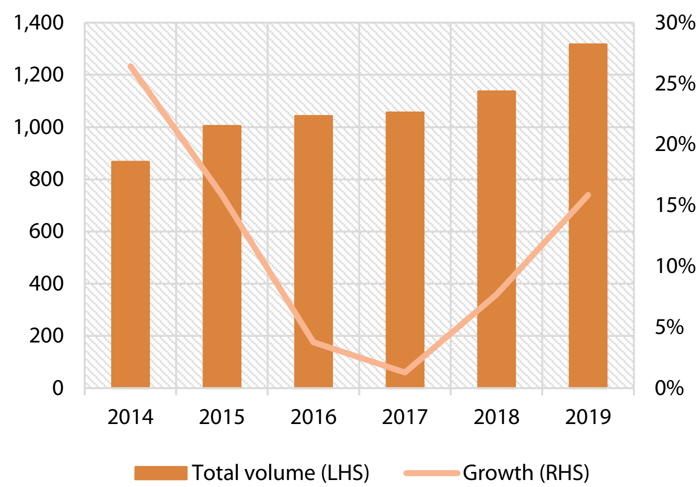
100%. Besides, the booming construction steel demand in Cambodia helped SMC to increase its export volume by 30%.

Figure 18: SMC's revenue and net income (VND billion)



Source: SMC

Figure 19: SMC's selling volume (thousand tons)

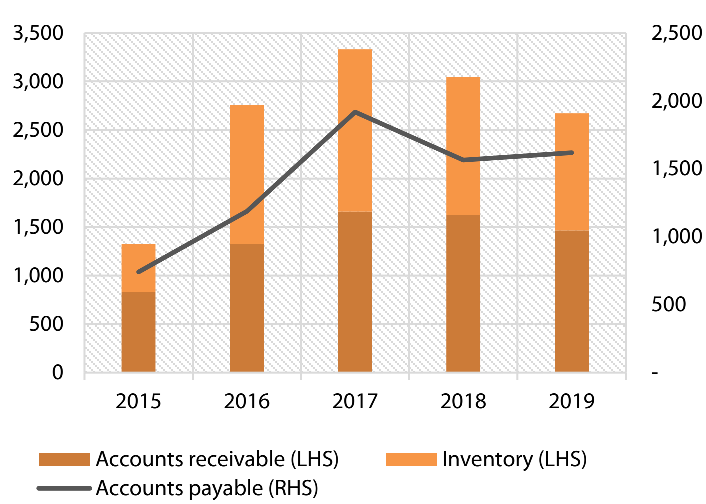


Source: SMC

SMC's ability to manage working capital improved in the 2018-2019 period, which led to a significantly shorter cash conversion cycle and higher cash flow from operations. Its cash conversion cycle decreased from 43.0 days in 2017 to just 27.3 days in 2019. Meanwhile, cash flow from operations recovered strongly in 2019, from VND -43 billion in 2018 to VND 490 billion. Because steel prices were in a downtrend, SMC intentionally cut its accounts receivable and inventory to reduced credit and market risks.

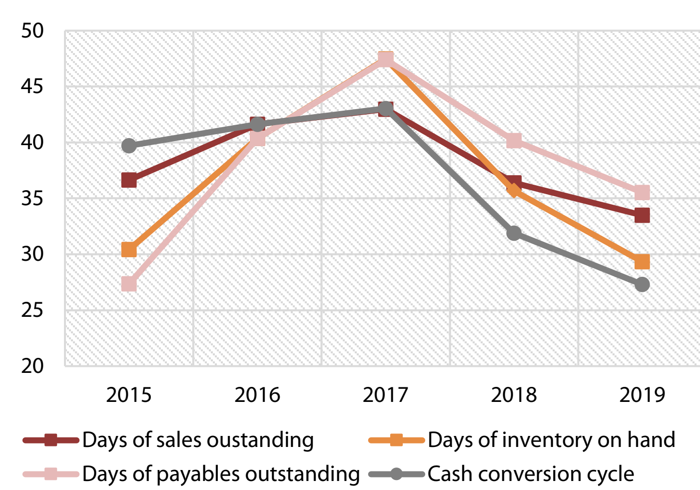
We believe that the improvement in SMC's working capital management and the increase in its selling volume showed the company has experience and competency to guarantee a balance between risks and opportunities during tough market conditions.

Figure 20: SMC's working capital (VND billion)



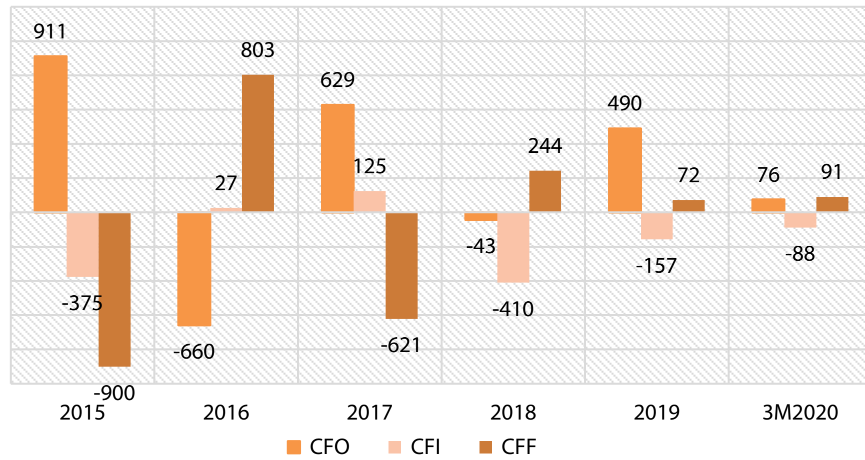
Source: SMC

Figure 21: SMC's turnover ratio (days)



Source: SMC

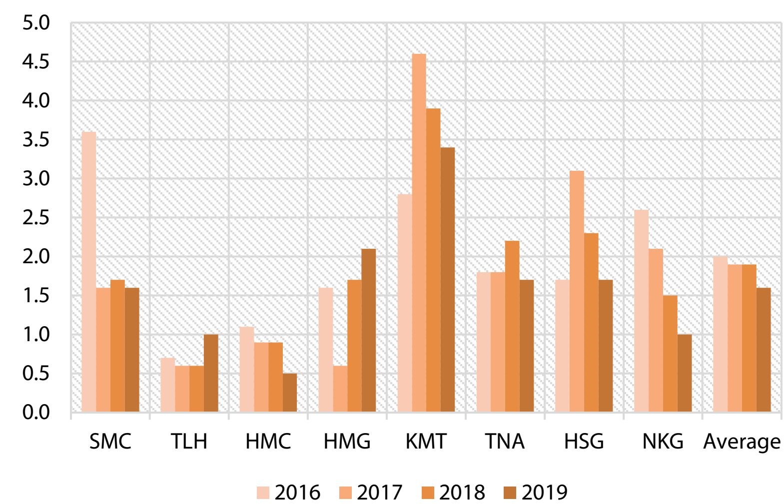
Figure 22: SMC's CFO, CFI and CFF (VND billion)



Source: SMC

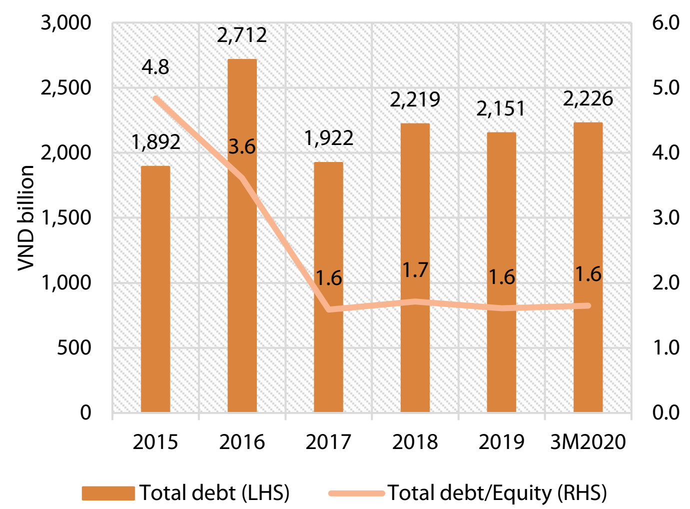
The financial leverage and liquidity ratios have become safer. In 2017, SMC's total debt/equity decreased sharply from 3.6 times to 1.6 times, although its total debt decreased by just 29% YoY from VND 2,712 billion to VND 1,922 billion. The reason is that its net income in 2017 was large which led to significantly higher equity. Currently, SMC's total debt to equity ratio stabilized at an average ratio of 1.6 times.

Figure 23: Listed steel trading companies' debt to equity ratio



Source: Surveyed companies' financial statements

Figure 24: SMC's borrowings

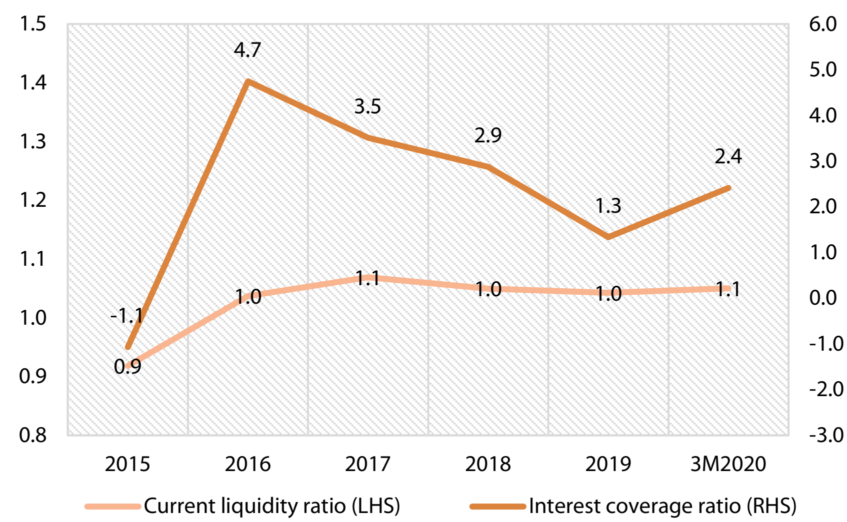


Source: SMC

Similar to financial leverage, SMC kept its current liquidity ratio stable at roughly 1.1x during the 2016-1Q2020 period. Meanwhile, its interest coverage ratio decreased steadily from 4.7x in 2016 to 2.4x in 1Q2020, which can be explained by the lower EBIT.

We believe SMC will not face financial difficulties in the intermediate term to finance its working capital and projects as it still has VND 950 billion of cash and short-term investments, equivalent to 18% of its total asset. In the short term, the company is in possession of a high cash balance to invest in inventories and receivables in case steel prices and demand recovered after the pandemic. This could also be a scenario supported by high public investment and FDI inflows. In the next two year, the company will need roughly VND 150 billion to expand its coil center in Da Nang and steel pipe factory.

Figure 25: SMC's liquidity ratio



Source: SMC

Outlook and forecast

In 2020, we forecast that SMC's selling volume will reach 1.25 million tons, which is similar to the company's guidance. In 5M2020, Vietnam's steel industry was hit strongly by COVID-19 as the selling volume of construction steel, steel pipe and coated steel segments decreased by 10.2%, 10.8%, and 4.2% respectively. However, SMC's selling volume just decreased by 6% in 1H2020. In May and June 2020, there was a strong recovery in its selling activities as it sold roughly 115 million tons of steel products, increasing by 8.5% YoY. Due to the possible lagging impact of COVID-19, we forecast conservatively that its selling volume in 2H2020 will decrease at a slower pace of 3% YoY.

Table 4: Selling volume forecast in each segment (tons)

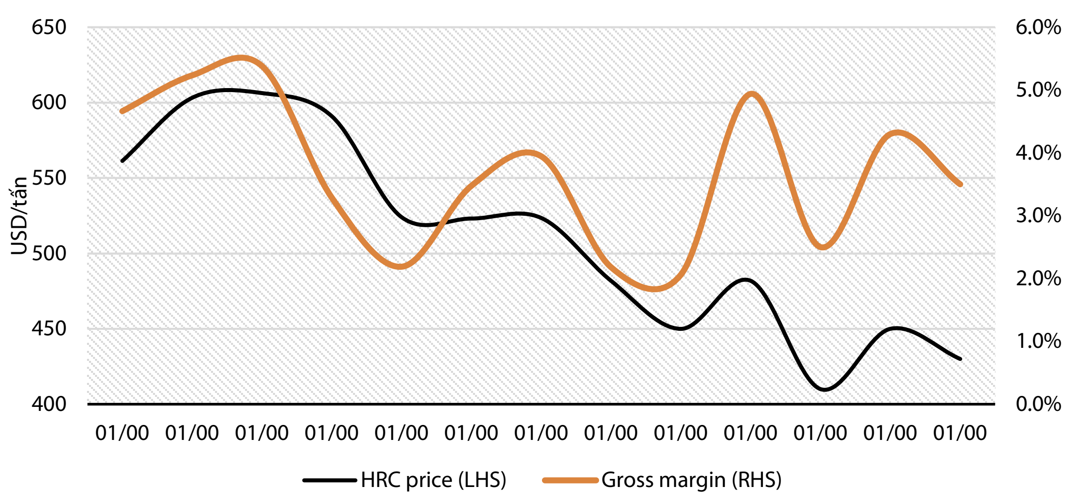
	2019	2020F	2021F
Steel trading	687,570	646,316	704,484
Growth		-6.0%	9.0%
Steel pipe	141,518	135,857	149,443
Growth		-4.0%	10.0%
Coated steel	285,000	273,600	295,488
Growth		-4.0%	8.0%
Steel processing	406,667	397,314	425,126
Growth		-2.3%	7.0%

Source: Rong Viet Securities

For 2020, we forecast SMC's revenue will decreased by 11.8% to VND 14,850 billion, while its net income will be stable at VND 93 billion. We estimate that:

- Construction steel, steel pipe, and processed coil prices will decrease by 4.0%, 10.9%, and 10.8% respectively. Meanwhile, HRC prices will decrease by 12.0% YoY. We expect HRC prices to recover and stabilize at USD 440/ton from 3Q2020, increasing by 6% compared to 2Q2020. Owing to the recovery in HRC prices in 2H2020, SMC's gross margin is expected to increase from 2.9% to 3.6%.
- The new coil center in Da Nang City will contribute 2.8% to the coil service segment's selling volume.

Figure 26: SMC's gross margin forecast



Source: SMC

For 2021, we expect SMC to benefit from the recovery in the steel industry's growth owing to public investments in infrastructure and FDI inflows. We forecast that:

- Construction steel, steel pipe, coated steel and coil process's selling volume will increase by 9%, 10%, 8% and, 7% YoY respectively.
- The company's gross margin could increase to 4.3% due to the recovery in steel prices.

Table 5: Revenue and gross profit forecast (VND billion)

	2019	2020F	2021F
Revenue	16,836	14,850	16,645
Revenue growth	2%	-12%	12%
Steel trading	8,059	7,231	8,127
Steel pipe	2,197	1,879	2,149
Coated steel	4,258	3,641	4,082
Internal	-3,937	-3,358	-3,773
Coil processing	6,259	5,456	6,060
Gross profit	490	534	714
Steel trading	135	155	203
Steel pipe	89	89	119
Coated steel	106	115	156
Coil processing	160	175	235
Gross profit margin	**2.9%**	**3.6%**	**4.3%**

Source: Rong Viet Securities

We also assume:

- Selling and G&A expenses to stabilize at VND 156 billion and VND 119 billion in 2020 and increase strongly in 2021 to VND 208 billion and VND 151 billion due to the high growth in sales.
- Interest expenses to decrease by 8.8% from VND 153 billion in 2019 to VND 140 billion in 2020.

VALUATION

We use two methods including discounted cash flow (DCF) and multiples (P/E for trading segment and P/B for manufacturing segment) with the proportion of 50% and 50%, respectively, to determine the fair value of SMC:

- DCF valuation method assumes a weighted average cost of capital of 12.9% and exit EV/EBITDA multiple of 6.3x.
- In the multiple approach, we use P/B of 0.6x to estimate the value per share of the manufacturing segment, and a P/E of 4.3x to estimate the value per share of the trading segment.

Table 6: Valuation result (VND)

	Segment	Method	Weight	Price	Contribution
DCF	The whole company	FCFF	50%	11,821	5,910
Multiples	Trading	P/E (4.3x)		992	
	Manufacturing	P/B (0.6x)		11,417	
		Sum of the parts	50%	12,410	6,205
Target price					**11,100**
Cash dividend					**1,000**
Current price					**10,400**
Upside					**16%**

Source: Rong Viet Securities

Discounted cash flow to the firm (FCFF) method

Applying the FCFF method, we use an exit EV/EBITDA of 6.3x, which is 10% lower than the industry median in Vietnam. To account for the possible variation of steel prices, which have a large volatility, we add a premium of 2.0% to the cost of equity in the 2020-2024 period. We estimate the fair value of SMC at VND 11,821 per share with details below:

Cost of Capital		Valuation by DCF	
Equity risk premium	17.9%	Present value of FCFF in the next five years (VND billion)	560.4
Risk-free rate	3.2%	Present value of Terminal value (VND billion)	1,746
Cost of equity	19.6%	Equity value (VND billion)	752.1
Cost of debt	7.4%	Number of shares outstanding (million)	61.0
Total debt/total assets	48.5%	**Target price (VND/share)**	**11,821**
Total equity/total assets	51.5%		
Corporate tax rate	20.0%		
WACC	**12.9%**		

Relative multiples

In the manufacturing segment, we choose Vietnam's listed steel manufacturers to estimate industry's median P/B multiple of 0.6x. Meanwhile, we use a P/E multiple of 4.3x to estimate the fair value per share of the trading segment based on SMC's average P/E in the last four years.

Table 7: Manufacturing segment's multiples

Company	Stock	Capitalization	P/B	P/E
Hoa Sen Group	HSG	4,361.7	0.77	8.97
Viet Nam Steel	TVN	4,649.7	0.55	12.81
Vietnam Germany Steel Pipe	VGS	345.3	0.50	4.59
Nam Kim Group	NKG	1,474.2	0.49	32.31
Thu Duc Steel	TDS	161.3	0.59	6.10
Nha Be Steel	TNB	134.5	0.69	8.33
Dai Thien Loc	DTL	626.6	0.63	N/A
Pomina	POM	1,569.5	0.45	N/A
Average			**0.59**	**12.19**
Market capital weighted average			**0.61**	**13.48**
Median			**0.59**	**8.33**

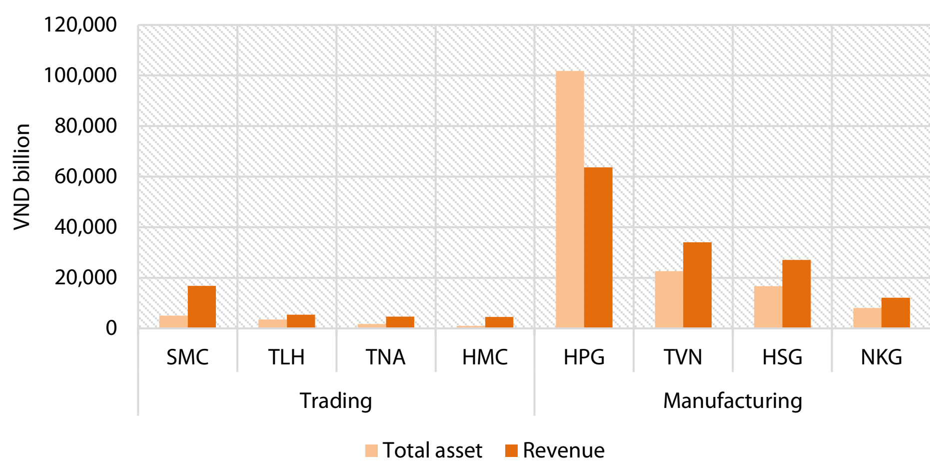
Source: Rong Viet Securities

INDUSTRY OVERVIEW

Steel manufacturers are depending on trading companies to distribute their products

Steel manufacturers face difficulties in developing their retail systems. Firstly, they must increase working capital and capital expenditures to finance increasing inventories and costs to build new stores, such as land renting costs and construction costs. Increasing inventory also leads to higher exposure to market risks, which is already high for manufacturers as they often lose money in tough market conditions. Secondly, these companies also face competition from existing stores, which are already operating in various area. Thirdly, opening a new retail system takes lots of time and costs to cover a large area and build a strong sales team to compete with existing retailers who have good relations with local customers. At the beginning new retailers often offer a competitive price or discount to attract customers. Lastly, a retail system selling products of only one manufacturer will lack choices for customers, who may prefer a cheaper or higher-quality product or a favorite brand.

Figure 27: The scale of largest listed companies in the steel trading and steel manufacturing segments



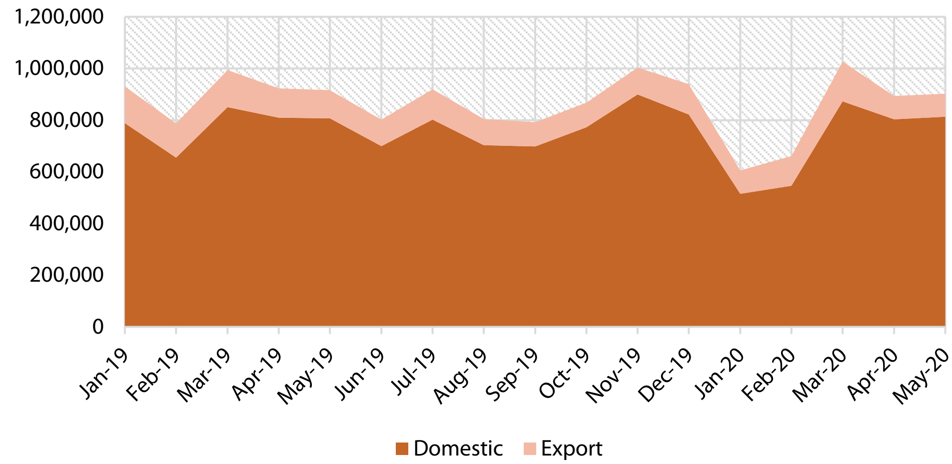
Source: Surveyed companies' financial statements

The steel industry was hit strongly by COVID-19 but the domestic consumption of coated steel and steel pipes is recovering well

In 5M2020, the domestic steel consumption and construction industry was hit strongly by COVID-19. The government's measures to control the pandemic, including travel restrictions of people and goods, social distancing, and the disruption in the international supply chain affected negatively production and consumption. The construction industry grew at a pace of 4.4% in 5M2020, significantly lower than the pace of 9.2% in 2019. Meanwhile, domestic consumption of construction steel and steel pipes fell by 10.2% and 10.8%, respectively. The domestic consumption of coated steel decreased at a slower pace of 4.2%.

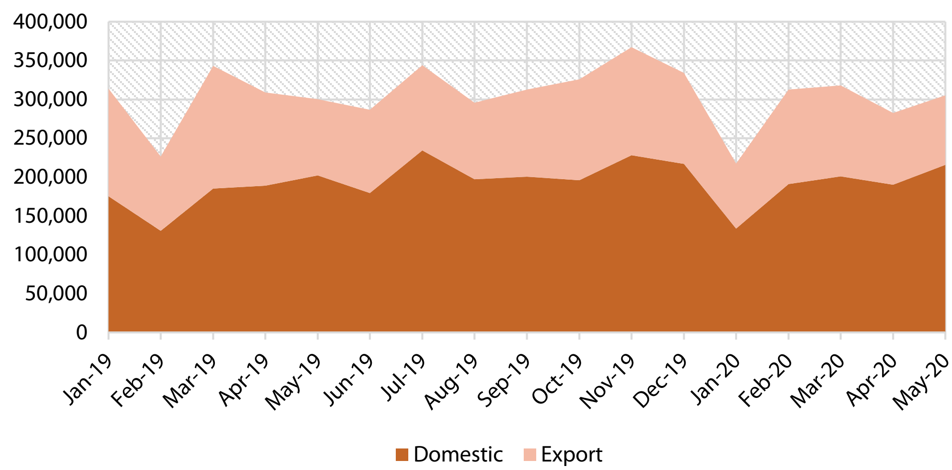
After decreasing due to the impact of the pandemic and Tet holiday, the domestic steel consumption has recovered significantly since March, but exports have not improved in April and May. In the March-May 2020 period, the domestic consumption of construction steel and coated steel increased slightly by 0.9% and 5.3% YoY respectively. Noticeably, the domestic consumption of steel pipes rebounded in May to 216 thousand tons, increasing by 10.6% YoY.

Figure 28: Construction steel consumption, by market (tons)



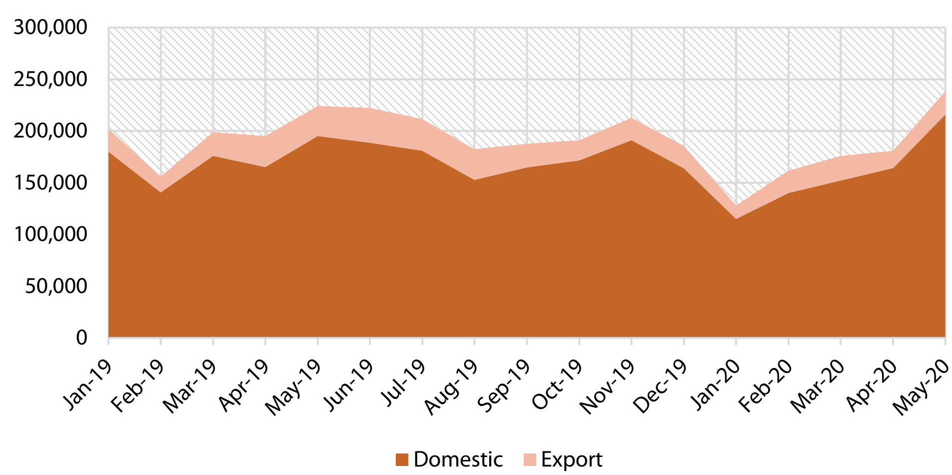
Source: VSA

Figure 29: Coated steel consumption, by market (tons)



Source: VSA

Figure 30: Steel pipe consumption, by market (tons)

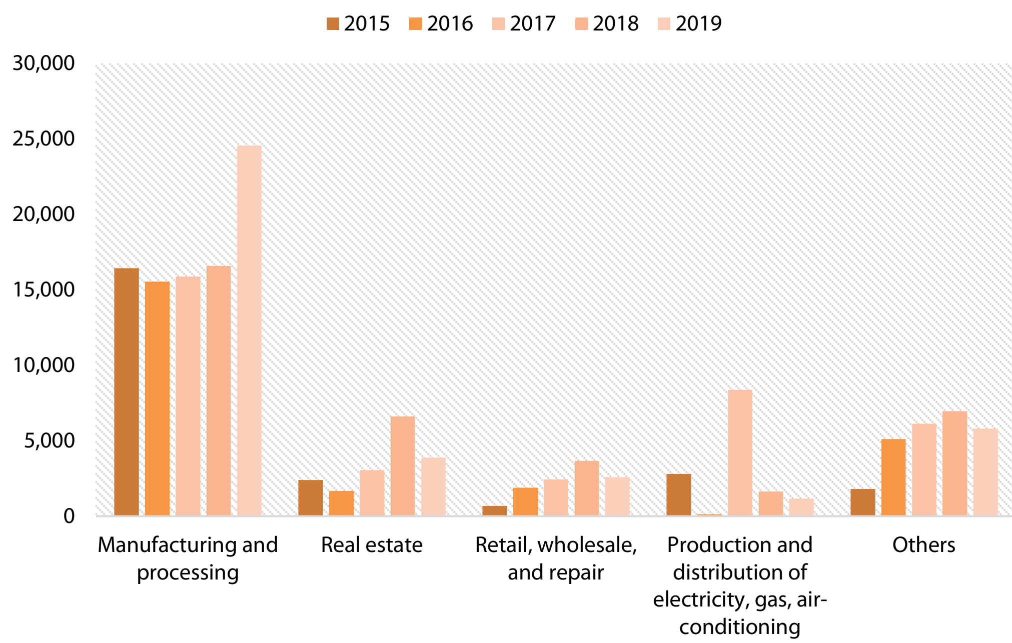


Source: VSA

A large portion of FDI in Vietnam flows to manufacturing and processing

Due to the advantage of low labor costs, Vietnam is the destination of many large manufacturers in labor-intensive industries and even industries that require skilled laborers, such as electronics and computer production. In 2019, 65% of FDI in Vietnam was spent on the manufacturing and processing segments. Although FDI in Vietnam increased by just 7.2%, the FDI in the manufacturing and processing segment increased by 48.1%. Due to the need of building new factories in this segment, the demand for steel pipe and coated steel has been well supported.

Figure 31: FDI in Vietnam, by sector (USD million)



Source: Ministry of Planning and Investment, Rong Viet Securities

Unit: VND billion

PROFIT & LOSS STATEMENT	FY2018	FY2019	FY2020E	FY2021F
Revenue	16,466	16,836	14,850	16,645
COGS	15,812	16,346	14,316	15,931
Gross profit	**654**	**490**	**534**	**714**
Selling expenses	188	160	156	208
G&A expenses	131	125	119	151
Financial income	31	103	14	6
Financial expense	159	167	157	138
Other income/loss	27	5	5	5
Gain/(loss) from JV	-3	0	4	5
Profit Before Tax	**231**	**146**	**126**	**233**
Tax expense	63	46	25	47
Minority interests	-4	8	8	11
Profit After Tax	**172**	**92**	**93**	**176**
EBIT	335	204	260	355
EBITDA	417	296	360	455

FINANCIAL RATIO	FY2018	FY2019	FY2020E	FY2021F
Growth (%)				
Revenue	30.1	2.2	-11.8	12.1
EBITDA	-5.8	-29.1	21.6	26.5
EBIT	-10.7	-39.1	27.2	36.6
PAT	-36.5	-46.6	0.9	90.1
Total assets	0.6	0.6	3.7	2.8
Total equity	8.7	2.7	22.1	7.2
Profitability (%)				
Gross margin	4.0	2.9	3.6	4.3
EBITDA margin	2.5	1.8	2.4	2.7
EBIT margin	2.0	1.2	1.7	2.1
Net margin	1.0	0.5	0.6	1.1
ROA	3.4	1.8	1.7	3.2
ROCE	23.9	14.5	15.2	19.5
ROE	13.7	7.1	5.9	10.5
Efficiency (x)				
Receivables turnover	10.1	11.5	8.3	8.7
Inventories turnover	11.1	13.5	10.0	9.4
Payables turnover	10.1	10.1	8.1	8.3
Liquidity (x)				
Current	1.1	1.0	1.1	1.2
Quick	0.7	0.7	0.8	0.7
Finance Structure (%)				
Total debt/equity	177.6	167.6	121.4	107.0
ST debt/equity	169.7	162.1	116.4	102.2
LT debt/equity	7.9	5.5	4.9	4.8

Unit: VND billion

BALANCE SHEET	FY2018	FY2019	FY2020E	FY2021F
Cash and cash equivalents	190	596	316	111
Short-term investments	239	274	274	274
Accounts receivable	1,626	1,464	1,782	1,914
Inventories	1,419	1,209	1,432	1,689
Other current assets (inc. non-trade receivables)	398	318	333	350
Property, plant & equipment	839	776	686	626
Acquired intangible assets (Inc. Goodwill)	140	138	138	137
Long term investments	149	239	239	240
Other non-current assets	84	97	102	107
Total assets	**5,083**	**5,112**	**5,303**	**5,449**
Accounts payable	1,563	1,619	1,775	1,912
Short-term borrowings	2,121	2,081	1,825	1,717
Long-term borrowings	99	70	77	81
Other non-current liabilities	2	2	2	2
Bonus and Welfare fund	4	4	4	4
Technology-science development fund	0	0	0	0
Total liabilities	**3,789**	**3,776**	**3,682**	**3,716**
Common stock and APIC	801	864	1,117	1,117
Treasury stock	0	0	0	0
Retained earnings	163	109	138	248
Other comprehensive income	30	1	1	1
Investment & Development Fund	256	310	312	316
Total equity	**1,249**	**1,283**	**1,567**	**1,680**
Minority Interest	**45**	**53**	**53**	**53**

CASH FLOW STATEMENT	FY2018	FY2019	FY2020E	FY2021F
Profit before tax	231	146	126	233
Depreciation	56	64	100	100
Adjustments	199	138	0	0
Change in Working capital	-529	143	-426	-316
Net Operating CFs	**-43**	**490**	**-200**	**18**
Change in Fixed Asset	-293	24	-15	-45
Change in Deposit, equity investment	-115	-182	0	0
Interest, dividend, cash profit	-3	1	0	0
Net Investing CFs	**-410**	**-157**	**-15**	**-45**
Change in Capital	130	60	0	0
Change in Debt	298	-68	-249	-103
Dividend paid & other	-184	81	181	-74
Net Financing CFs	**244**	**72**	**-68**	**-177**
Beginning cash & equivalents	**398**	**190**	**598**	**316**
Change in cash & equivalents	-209	405	-282	-205
Ending cash & equivalents	**191**	**598**	**316**	**111**

Company Report

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.

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Ratings	BUY	ACCUMULATE	REDUCE	SELL
Total Return including Dividends in 12-month horizon	>20%	5% to 20%	-20% to -5%	<-20%

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