March, 2020

DA NANG RUBBER JSC (HSX: DRC)

Sales increased slightly while GPM improved significantly

Particulars (VND bn)	4Q-FY19	3Q-FY19	+/- qoq	4Q-FY18	+/- yoy
Net revenue	968	971	-0.3%	999	-3.2%
PAT	81	82	-1.4%	33	147.4%
EBIT	109	112	-2.2%	54	100.7%
EBIT margin	11.3%	11.5%	-21.7 bps	5.4%	584.0 bps

Source: DRC, Rong Viet Securities

2019: Radial segment was the main contributor to DRC's growth

- Revenue in 2019 was VND 3,858 billion, up 8.6%. The bias segment recorded a decline in revenue of -11.6%, to VND 1,203 billion. On the contrary, radial tire sales grew by (+13.1%) as it went up by 34.2%, to VND 1,916 billion due to an increase of 36% in sales volume, to 511,005 tires.
- The GPM increased from 12% in 2018 to 14.8%. Most of DRC's products had higher GPM than during the previous year. In fact, the two main products (bias and radial tires) saw GPM improving from 22.5% to 24.4% and 2.6% to 9.5%, respectively. The main reason was a big decrease of material prices while selling prices dropped only slightly.
- The expansion of radial production and selling activities boosted the selling and administrative expenses by 12.6% and 12.4%, respectively. Meanwhile, interest expenses declined by 16.4% YoY.
- PBT of the company reached its highest level of the past three years (VND 313 billion, +79% YoY). PAT was VND 250 billion, up 81% YoY and EPS was VND 2,108.

2020 Outlook

We forecast that DRC can achieve VND 3,730 billion of net revenue (-3% YoY) and VND 306 billion of net income (+22% YoY) in 2020.

The radial segment will continue to play a key role in the company's business with expected output growing from 511,000 tires to 521,000 tires (+2% YoY). GPM is forecasted to improve from 9.5% to 15.3%. In contrast, bias production is expected to fall from 626,000 tires (in 2019) to 550,000 tires (-12% YoY) while GPM is expected to climb slightly from 24.4% to 26.7%. The company's gross profit will increase by 15% YoY, to VND 659 billion. Besides, selling, administration and interest expenses will go up by 8%, 6% and 6%, respectively. As a result, net income will increase by 22%, to VND 306 billion.

Valuation and recommendation

We believe that DRC can maintain its revenue growth steady while improving profit in 2020. The radial segment will operate efficiently with higher profit and still has room to grow. Meanwhile, although the bias segment has shrunk, it still accounts for a relatively high proportion of total profit. Recently, the company has been planning to expand the capacity of its radial plant. The official implementation of the project will be positive for the company's future.

*We have a target price of **VND 22,500/share** , **52%** higher than the closing price on 30/03/2020. We recommend a **BUY** for this stock.*

BUY	**+52%**
Target price (VND)	22,500
Current market price (VND)	15,450
Cash Dividend (VND)*	1,000

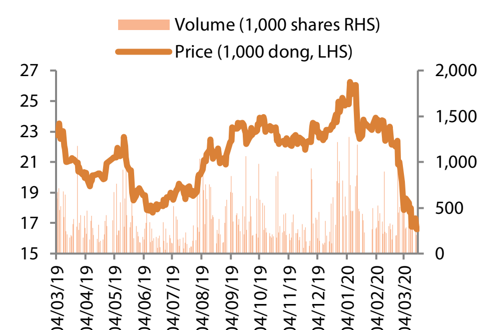
(*) Expected in the next 12 months

Stock Info

Sector	Automobile & Parts
Market Cap (VND billion)	2,554
Current Shares O/S	118,792,605
Avg. Daily Volume (in 20 sessions)	420,100
Free float (%)	41
52 weeks High	26,250
52 weeks Low	15,450
Beta	1.11

	FY2018	Current
EPS	1,085	2,108
EPS Growth (%)	-16	94
Diluted EPS	1,085	2,108
P/E	19.8	7.9
P/B	1.7	1.2
EV/EBITDA	6.5	4.0
Cash dividend yield (%)	5	4.7
ROE (%)	9.1	15.9

Price performance



Major Shareholders (%)	
VINACHEM	50.5
Foreign ownership room (%)	27

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Exhibit 1: 4Q2019 Results

(VND Bn)	4Q-FY19	3Q-FY19	+/-(qoq)	4Q-FY18	+/-(yoy)
Net revenue	968	971	-0.3%	999	-3.2%
Gross profit	170	162	4.9%	109	55.7%
SG&A	53	45	17.6%	48	10.5%
Operating income	117	117	-0.1%	61	91.3%
EBITDA	403	326	23.7%	569	-29.3%
EBIT	109	112	-2.2%	54	100.7%
Financial expenses	19	19	3.8%	28	-30.6%
- Interest Expenses	8	9	-10.9%	13	-35.4%
Dep. and amortization	293	214	37.2%	515	-43.0%
Non-recurring items (*)					
Extraordinary items (*)					
PBT	101	102	-1.4%	42	142.9%
PAT	81	82	-1.4%	33	147.4%
(*) Adjusted PAT	81	82	-1.4%	33	147.4%

Source: DRC, Rong Viet Securities

Exhibit 2: 4Q2019 Performance Analysis

Particulars	4Q-FY19	3Q-FY19	+/-(qoq)	4Q-FY18	+/-(yoy)
Profitability Ratios (%)					
Gross Margin	18%	16.7%	87.0 bps	10.9%	665.4 bps
EBITDA Margin	42%	33.5%	807.0 bps	57.0%	-1,536.7 bps
EBIT Margin	11%	11.5%	-21.7 bps	5.4%	584.0 bps
Net Margin	8%	8.4%	-9.4 bps	3.3%	507.3 bps
Adjusted Net Margin	8%	8.4%	-9.4 bps	3.3%	507.3 bps
Turnover *(x)					
-Inventories	3	3.5	-0.5	4.2	-1.2
-Receivables	21	16.9	4.1	12.6	8.4
-Payables	9	9.3	-0.1	11.0	-1.9
Leverage (%)					
Total Debt/ Equity	57%	52%	467.6 bps	70%	-1,311.5 bps

Source: DRC, Rong Viet Securities

Exhibit 3: 1Q2020 Performance Forecast

Particulars (VND Bn)	1Q-FY20	+/- qoq	+/- yoy
Revenue	787	-19%	-4%
Gross profit	141	-17%	77%
EBIT	91	-17%	175%
NPAT	61	-25%	258%

Source: Rong Viet Securities

Update

Radial segment recorded a strong growth in both revenue and profit due to increased output and improved profit margin

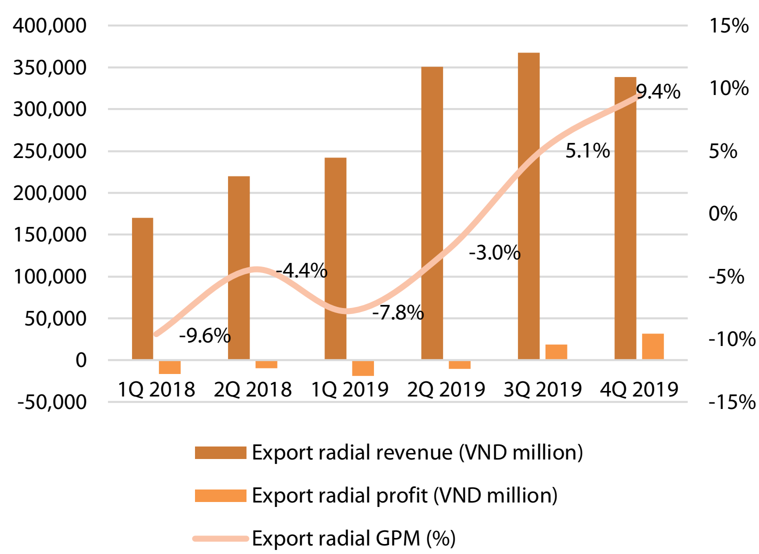
In 2019, DRC's total net revenue was VND 3,858 billion, equivalent to an increase of 8.6% compared to 2018. Growth mainly came from the **radial segment with revenues of VND 1,916 billion, up 34.2%.** This was mainly due to a sharp increase of 36% in sales volume, to 511,005 tires. The selling price decreased slightly by 1.4% and the production cost recorded a sharp decline (due to lower raw material prices and lower depreciation costs per unit). As a result, gross profit margin (GPM) improved from 2.6% to 9.5%. **Therefore, the gross profit of the radial segment reached VND 183 billion, up 4.9x.**

Radial export markets

Revenue in 2019 reached VND 1,298 billion. Output reached 377,144 tires, helping the proportion of exported radial tires to total radial tires increase from 66.6% in 1Q2018 to 75.9% at the end of 2019. A significant jump in output was contributed by the US and Brazil. Currently, the US accounts for 37% of monthly exports while Brazil accounts for 47%. DRC has started exporting to the US since early 2019.

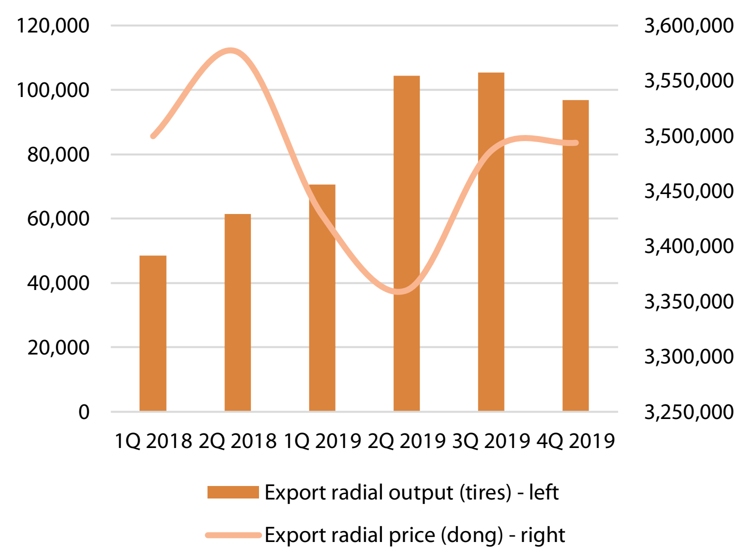
The export price was less volatile compared to 2018. The continuous decrease in production costs during the year helped exports of radial GPM improve sharply from the negative in the period of 1Q2018 to 2Q2019 to 5.1% (3Q2019) and 9.4% (4Q2019). The GPM of the export channel in 2019 reached 1.6% compared to the negative GPM of 2018. **Gross profit in 2019 reached VND 21 billion.**

Figure 1: Revenue and profit of exported radial tires



Source: DRC, Rong Viet Securities

Figure 2: Export volume and price of exported radial tires

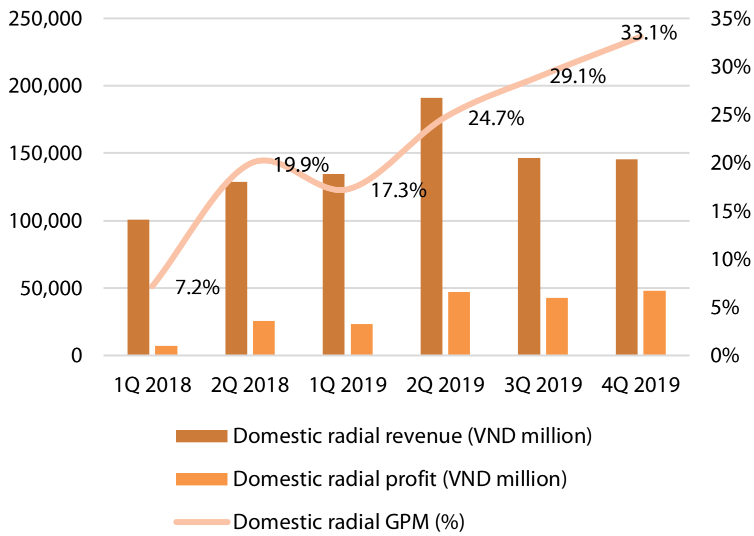


Source: DRC, Rong Viet Securities

Radial domestic market

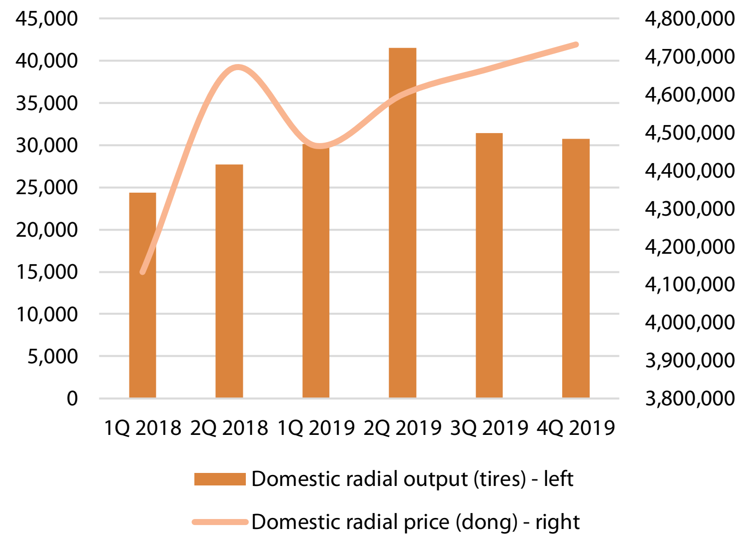
Revenue in 2019 reached VND 618 billion. Consumption reached 133,861 tires. In comparison to the export market, the domestic price was 30-37% higher than export prices because of the long-term economic relationship between DRC and its partners. Domestic prices have continuously increased over the quarters of 2019, helping the domestic radial GPM climb from 17% in 1Q2019 to 33% in 4Q2019. **Gross profit in 2019 reached VND 161 billion.**

Figure 3: Revenue and profit of domestic radial tires



Source: DRC, Rong Viet Securities

Figure 4: Volume and price of domestic radial tires



Source: DRC, Rong Viet Securities

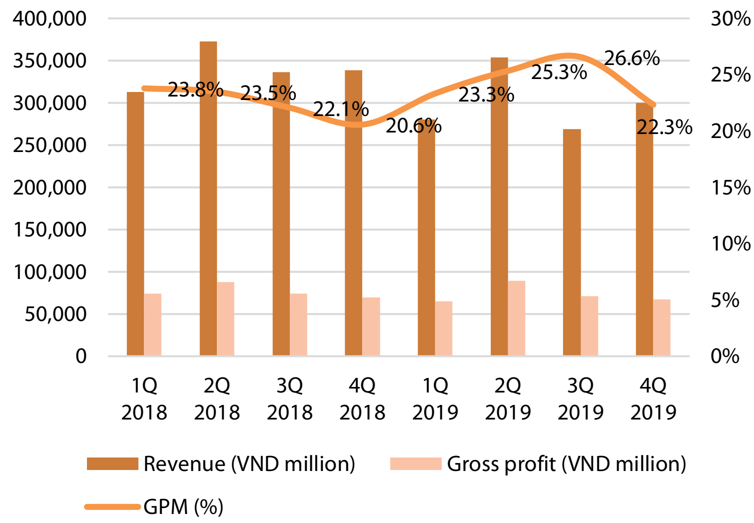
Bias tire segment: revenue dropped while GPM improved

Bias revenue decreased by 11.6% YoY to VND 1,203 billion. Sales volume declined slightly by 5.9% YoY (to 625,896 tires) while selling price fell by 6.1% YoY (average VND 1,922,000/tire). Bias tire sales volume in 2019 decreased but slower than the reduction in 2018 (-21% YoY) and 4Q is the only quarter of the year that recorded a growth compared to the same period (+0.8% YoY). In the assembly channel (OEM), automobile companies have gradually used more and more radial tires instead of bias tires due to their superior features. However, as FDI companies have focused on producing radial tires and gradually reduced the production of bias tires, that helped to low down the competition in the bias market. Thus, DRC's 2019 bias tire production did not dropped too drastically, only 5.9%. In 2020, DRC plans to produce 550,000 bias tires, a drop of 12% compared to 2019.

The decline in selling prices came from three reasons (1) lower input materials' price, (2) the demand of bias tires declined and (3) in 2019 the proportion of light truck bias tires (whose price is lower than heavy trucks prices) in the bias segment was higher than in 2018 (76% vs 74%), resulting in a lower average selling price.

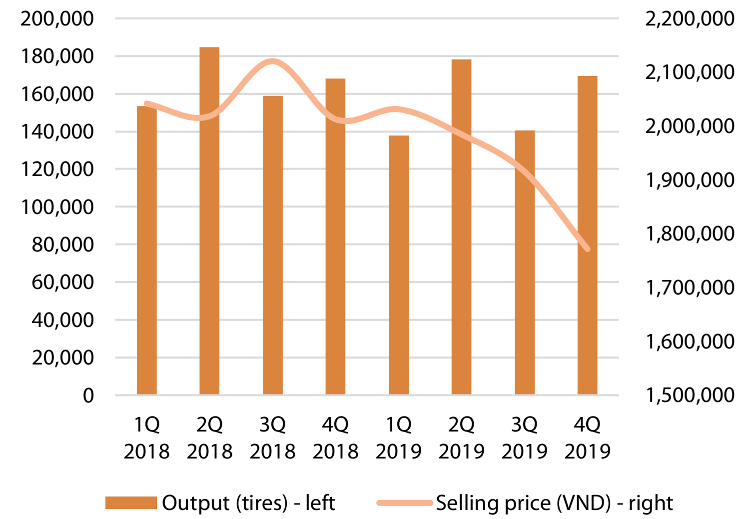
The GPM of the bias tire segment improved compared to 2018, when it increased from 22.5% to 24.4%. Indeed, the production cost per unit decreased much more than the decrease in selling price (-8.4% YoY compared to -6.1% YoY). In particular, the reduction of input prices was the main cause helping to reduce production costs per unit.

Figure 5: Revenue and profit of bias tires



Source: DRC, Rong Viet Securities

Figure 6: Volume and price of bias tires



Source: DRC, Rong Viet Securities

Currently, the majority of DRC's bias tires (75%) were sold in the domestic market via distribution agents and stores. The remaining 25% is exported mainly to other Asia countries and Middle East countries where the quality of roads is underdeveloped, so that the features of bias tire are more suitable than radial tires' features.

Because DRC's light truck bias tires did not meet the Euro 4 Emission Standard. Thus, the company has developed an alternative product – the light truck radial tires or semi-steel tires. The sales scale of the new products was relatively small and has not contributed to the company's profits because it was still in the "quality testing" phase. At the end of 2019, DRC bought 2 shaping machines costing USD 575,000. The capacity is expected to be about 180,000-200,000 tires/year. In 2020, DRC plans to produce and sell around 50,000 semi-steel tires and THACO is one of the first customers contacting to order these tires.

Table 1: DRC's plan of restructuring their products

Tires	Replaced by
Heavy truck bias tire	All steel radial tire
Light truck bias tire	Light truck radial tire (or semi-steel tire)

Source: DRC, Rong Viet Securities

Other segments: bicycle tire was the only one recording a growth in revenue (+10% YoY). DRC's other segments' revenue in 2019 decreased by 3% over the same period, reaching VND 739 billion - accounting for 19% of total revenue. GPM improved from 10.8% in 2018 to 13.8% in 2019. Therefore, the gross profit from the other segments rose dramatically by 28% YoY, reaching VND 102 billion, representing over 18% of the total gross profit.

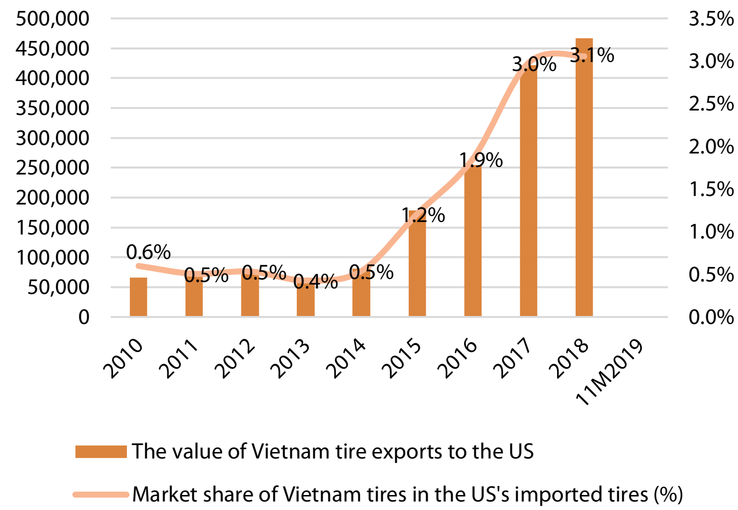
Opportunity of DRC when the US imposed tariffs on Chinese radial tires

DRC took advantage of the trade war between China and the US in order to increase its exports to the US. Besides of 10% import tax (4% applied to DRC's tires), the US also imposed two additional taxes, including (1) countervailing duty at 21-63% depending on the companies and (2) anti-dumping duty of 9% (tires imported from China are subjected to 23%). Those two additional duties have been effective since February 15, 2019 and will last for 5 years. These three taxes quickly affected negatively the Chinese tire industry as the proportion of Chinese tires on the total tires exported to the US dropped significantly from 15% (in 2018) to 7.8% (11M2019). We expect that these taxes will remain in 2020, so that DRC's exports to the US will stay the same.

Figure 7: China's export tires to the US (USD thousand)

Source: Trademap.org, Rong Viet Securities

Figure 8: Vietnam's export tires to the US (USD thousand)

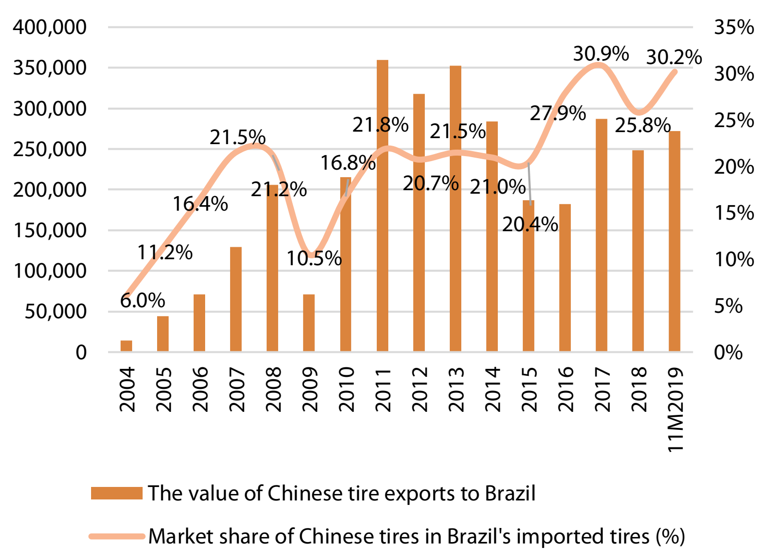


Source: Trademap.org, Rong Viet Securities

It is expected that DRC's exports to Brazil will not be affected even though anti-dumping duty on Chinese tires will expire at the end of April 2020

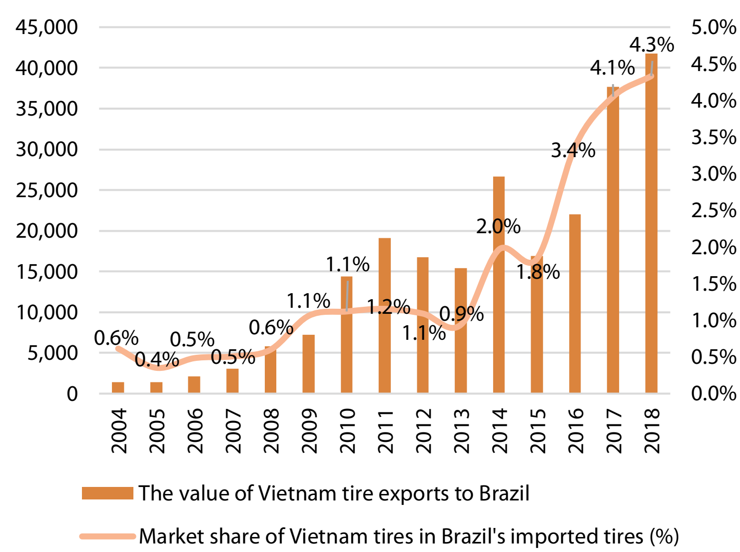
After the first anti-dumping duty imposed in 2009, the value of China's exported tires to Brazil plummeted at the end of 2009. However, due to the support from the Chinese Government plus the adjustment of Chinese companies, Chinese export value has increased since 2010. During the period from June 17, 2014 to April 29, 2015, Chinese tires were not subjected to anti-dumping duty from Brazil, but China's market share in 2014 and 2015 did not change much. Therefore, it can be seen that the Brazilian anti-dumping duty imposed on Chinese tires has not had much impact on Chinese companies. As a result, the booming in Vietnam's tire market share in Brazil for the last few years did not come from the anti-dumping imposition of Brazilian on China. Moreover, since 2014 Chinese tire companies have diversified into other markets instead of focusing on a few markets as before. That helped Chinese companies avoid some negative reactions from their main exporting destinations. As a result, we believe that the market share of Chinese tires exported to Brazil will not change much in 2020.

Figure 9: China's exported tires to Brazil (USD thousand)



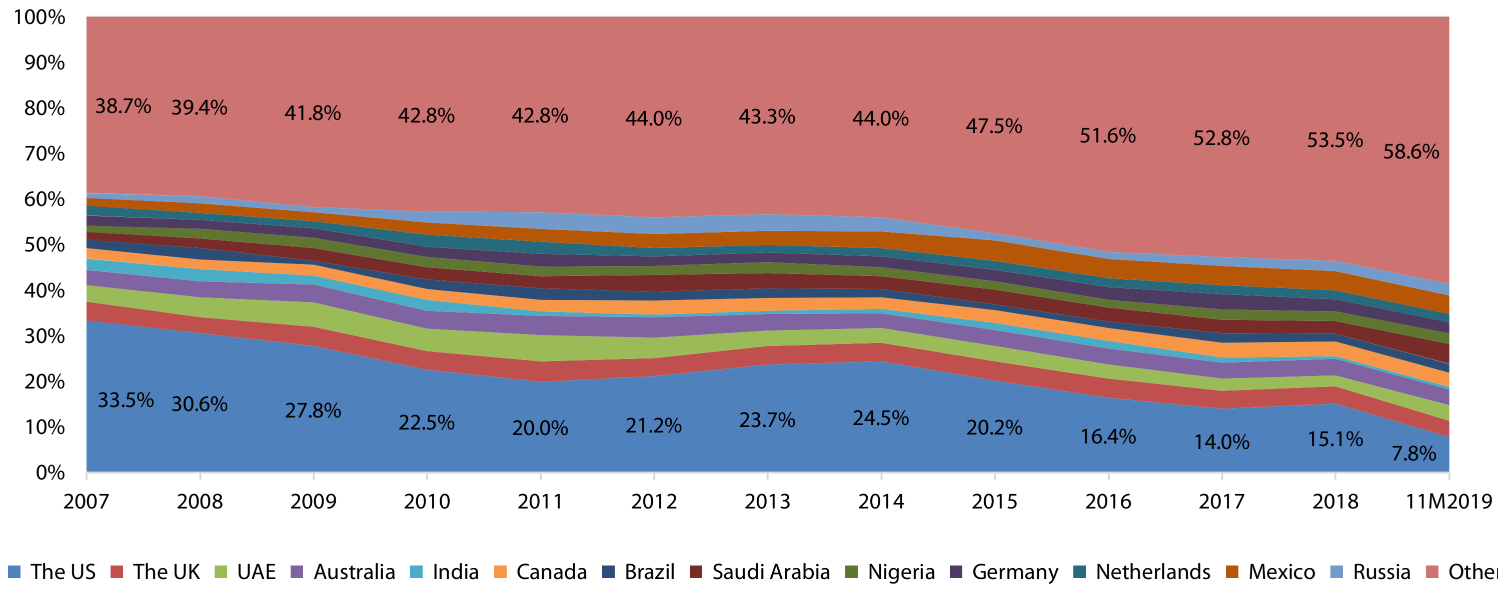
Source: Trademap.org, Rong Viet Securities

Figure 10: Vietnam's exported tires to Brazil (USD thousand)



Source: Trademap.org, Rong Viet Securities

Figure 11: Export markets of China



Source: Trademap.org, Rong Viet Securities

DRC plans to raise the capacity of its radial factory from 600,000 tires/year to 1,200,000 tires/year

Since 3Q2019, DRC has finalized the plan and asked for the approval from the parent company - Vinachem. The total investment will cost around VND 933 billion which is significantly lower than the total cost of the existing factory (VND 2,222 billion). The expansion only requires the installation of additional machinery and production lines into the existing facilities and there is no cost for the construction, leading to a lower cost. We believe that the company can manage to have enough cash for its project by using profits 2020 profit (estimated net income in 2020 will be VND 306 billion), cash (cash in 2019 was VND 46 billion) and loans. At the rate of 70-30, DRC will need about VND 280 billion while the rest of VND 653 billion will come from bank loans. Thus, DRC is absolutely able to use its own capital to implement this project. According to DRC, the project is expected to "kick off" in 2020 and take one year (including “paper work” as well as equipment procurement and installation). We estimate that when operating at its highest capacity (expected in 2025), the expanded radial plant can achieve revenue and gross profit of VND 4,544 billion (+137% compared to 2019) and VND 908 billion (+397% compared to 2019), respectively.

Valuation

In 2020, we expect DRC will generate a net revenue of VND 3,730 billion (-3% YoY) and net income of VND 306 billion (+22% YoY). This forecast is based on:

- The price of raw materials such as rubber will continue to decline due to a drop of Chinese demand which was caused by the Covid-19 epidemic. That will lead to the improvement of the total GPM from 14.8% to 17.7%. The radial tire segment will see an increase in GPM from 9.5% to 15.3%.
- Machinery and equipment of the 1st stage radial plant will be fully depreciated in September 2020. Therefore, in the last three months of 2020, DRC's depreciation expenses will decrease by VND 39 billion, contributing to improve the radial segment’s GPM.
- The expanding radial plant plan will start from the 3Q2020 and be operational by the end of the 2Q2021.

	Net revenue (VND billion)	GPM (%)
Radial segment	1,930	15.3
Bias segment	1,021	26.7
Others	779	11.8

In terms of valuation, we combine the P/E and FCFE methods with a proportion of 50% each in order to get a fair value for DRC.

P/E method: we took the proportional P/E of the average for 2019 P/E (16x - 30%) and the current P/E (8x - 70%), leading to 10.4x which is the reference P/E of DRC. The proportion of the current P/E is higher because we recognize that the current economic situation is changing due to the impact of the Covid-19 epidemic. We forecast an EPS of DRC in 2020 of VND 2,397, so that the appropriate price using this method is VND 24,926/share.

FCFE method: we use the following assumptions: (1) Cost of equity is 14.95% and (2) implied P/E is 5.8x.

Thereby, the fair value of DRC is **VND 22,500/share**. Plus, the expected dividend will be VND 1,000/share, so that **the profitability ratio** compared to the closing price on March 30, 2020 is **52%.**

Table 2: DRC valuation

Valuation model	Weight (%)	Price (VND)
FCFE	50%	20,060
P/E	50%	24,926
Target price (rounded)		**22,500**

Source: Rong Viet Securities

VND Billion

INCOME STATEMENT	FY2018	FY2019	FY2020F	FY2021F
Revenue	3,551	3,858	3,730	4,162
COGS	3,124	3,287	3,071	3,399
Gross profit	427	571	659	763
Selling Expense	113	127	137	143
G&A Expense	55	61	65	76
Finance Income	12	12	12	11
Finance Expense	98	82	87	122
Other profits	2	1	1	1
PBT	174	313	383	435
Prov. of Tax	36	63	77	87
Minority's Interest	0	0	0	0
PAT to Equity S/H	139	250	306	348
EBIT	259	383	457	545
EBITDA	530	656	677	676

%

FINANCIAL RATIO	FY2018	FY2019	FY2020F	FY2021F
Growth (%)				
Revenue	-3.2%	8.6%	-3.3%	11.6%
Operating Income	2%	23.8%	3%	0%
EBITDA	-5%	47.5%	19%	19%
PAT	-16.5%	80.7%	22.3%	13.6%
Total Assets	1%	-4.4%	19%	19%
Equity	0%	7.2%	9%	7%
Profitability (%)				
Gross margin	12%	15%	18%	18%
EBITDA margin	15%	17%	18%	16%
EBIT margin	7.3%	9.9%	12%	13%
Net margin	4%	6%	8%	8%
ROA	5%	9%	10%	9%
ROE	9%	15%	17%	18%
Efficiency				(lần)
Receivable Turnover	11.3	27.0	11.0	11.1
Inventory Turnover	3.7	2.9	2.7	2.6
Payable Turnover	9.0	8.5	12.0	7.5
Liquidity				(lần)
Current	1.2	1.5	1.6	1.5
Quick	0.4	0.2	0.5	0.4
Finance Structure (%)				
Total Debt/Equity	62%	42%	66%	77%
Current Debt/Equity	46%	33%	40%	39%
Long-term Debt/Equity	16%	9%	26%	38%

VND Billion

BALANCE SHEET	FY2018	FY2019	FY2020F	FY2021F
Cash and cash equivalents	51	46	69	35
Short-term investments	0	0	0	0
Accounts receivable	315	143	340	376
Inventories	846	1,153	1,122	1,306
Other current assets	35	36	40	44
Property, plant & equipment	1,512	1,256	1,572	1,986
Acquired intangible assets	5	4	0	0
Long-term investments	4	3	3	3
Other non-current assets	66	67	74	78
Total assets	**2,833**	**2,709**	**3,220**	**3,828**
Accounts payable	348	387	256	455
Short-term borrowings	707	532	718	738
Long-term borrowings	245	149	460	728
Other non-current liabilities	0	0	0	0
Bonus and Welfare fund	10	9	10	11
Technology-science, dev. fund	0	0	0	0
Total liabilities	**1,310**	**1,077**	**1,445**	**1,933**
Common stock and APIC	1,188	1,188	1,188	1,188
Treasury stock (enter as -)	0	0	0	0
Retained earnings	113	201	321	414
Other comprehensive income	21	21	21	21
Inv. and Dev. Fund	201	222	245	272
Total equity	**1,523**	**1,632**	**1,774**	**1,895**
Minority Interest	**0**	**0**	**0**	**0**

VALUATION RATIO (*)	FY2018	FY2019	FY2020F	FY2021F
EPS (dong)	1,073	1,960	2,397	2,723
P/E (x)	18.4	11.7	9.6	8.4
BV (dong)	12,819	13,738	14,938	15,953
P/B (x)	1.7	1.7	1.5	1.4
DPS (dong/cp)	1,100	1,000	1,000	1,500
Dividend yield (%)	5.1	4.7	4.7	7.0

VALUATION MODEL	Price	Weight	Average
FCFE	20,060	50%	10,030
PE	24,926	50%	12,463
Target price (VND)			**22,500**

VALUATION HISTORY	Price	Recommendation	Period
2019/04/17	23,500	Accumulate	Intermediate
2018/09/07	24,300	Reduce	Intermediate
2017/12/26	28,200	Neutral	Intermediate

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 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.

RATING GUIDANCE

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

ABOUT US

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