November, 2020

HOA PHAT GROUP JSC (HSX: HPG)

Potential, but encountering some uncertainty in the short term

(VND bn)	3Q-FY20	2Q-FY20	+/- qoq	3Q-FY19	+/- yoy
Net revenue	24,686	20,422	21%	15,087	64%
PAT	3,773	2,743	38%	1,755	115%
EBIT	4,707	3,291	43%	2,325	102%
EBIT margin	19.1%	16.1%	295bps	15.4%	366bps

Source: HPG, Rong Viet Securities

3Q2020 performance – Steel and agriculture segments performed well

- Due to its lower production cost, HPG competed through prices and doubled its sales in the Southern market to 234,000 tons in 3Q. Meanwhile, high demand from China boosted steel billet exports, which reached 510,000 tons.
- Hog prices varied in the range of VND 80,000-89,000/kg, hence, still supported the company's profit.
- GPM increased YoY from 17.9% to 20.9% due to the internal HRC capacity and stable steel production costs.

4Q2020 outlook – Uncertainty

For 4Q2020, HPG is going to sell roughly 930,000 tons of finished construction steel, increasing by 15% YoY. Meanwhile, increased iron ore prices will harm HPG's GPM in 4Q. Rebar prices are expected to rise steadily to VND 11,350/kg at the end of 2020, leading to our 2020 ASP forecast of VND 10,860/kg, -10% YoY. In the agriculture segment, its NPAT could decrease to roughly VND 318 billion, equivalent to 10% of its total net income. HPG's NPAT is estimated at roughly VND 11,940 billion in 2020, increasing by 59% YoY.

Valuation and recommendation

HPG is going to gain market share in both the Southern construction steel market and the flat steel segment. The company is the most competitive steel manufacturer in Vietnam due to its complete value chain, well-developed logistic system and relatively low production costs. Compared to other domestic manufacturers, HPG can take advantage to reduce production costs and control orders' timing. In the HRC segment, while Formosa is having difficulties to consume its products, HPG can use the majority of its HRC to produce pipes and GI/GL.

We will update HPG's 2021 outlook in the next report as iron ore and HRC prices are highly uncertain now. The pandemic could cause export difficulties and a slow recovery in income, which can lead to weak demand for automobiles and machinery.

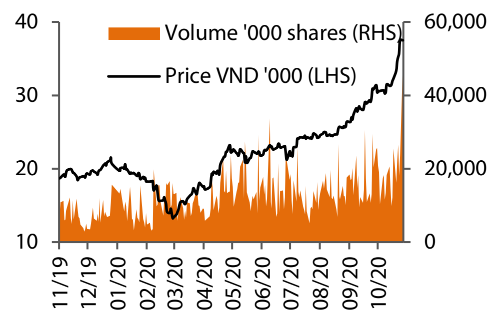
*We think that the positive results in 2020 have been priced in. We have come up with a target price of **VND 33,600** per share for now. Total downside as of November 26th is roughly 3%, thus, we are **NEUTRAL** on this stock in the **SHORT-TERM** and we will determine the target price for 2021 once the short-term impact of commodity prices have been analyzed. Investors wishing to hold HPG until the company's full potential at Dung Quat Steel Complex is realized can consider our FCFF valuation composition, which is remarkably more promising.*

NEUTRAL	-3%
Target price (VND)	33,600
Current market price (VND)	35,100
Cash dividend (VND)	500

Stock Info	
Sector	Basic Materials
Market Cap (VND bn)	93,103.6
Current Shares O/S (mn)	3,313.3
3M Avg. Volume (K)	6,036.7
3M Avg. Trading Value (VND bn)	362.5
Remaining Foreign Room (%)	10.9
52-week range ('000 VND)	20.3 - 35.7

	FY2019	Current
EPS (VND)	2,556	3,053
EPS Growth (%)	-32.6	21.9
Diluted EPS (VND)	2,130	3,053
P/E (x)	8.6	11.6
P/B (x)	1.4	1.9
EV/EBITDA (x)	7.7	6.4
Cash dividend yield (%)	0.0	1.4
ROE (%)	15.8	20.0

Price performance



Major Shareholders (%)	
Tran Dinh Long	25.2
Dragon Capital	8.0
Vu Thi Hien	7.3
Remaining ownership room (%)	10.9

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Exhibit 1: 3Q2020 Results

(VND Bn)	3Q-FY20	2Q-FY20	+/- qoq	3Q-FY19	+/- yoy
Net revenue	24,686	20,422	20.9%	15,087	63.6%
Gross profit	5,169	3,706	39.5%	2,702	91.3%
SG&A	462	415	11.4%	377	22.5%
Operating income	4,707	3,291	43.0%	2,325	102.5%
EBITDA	5,889	4,430	32.9%	2,977	97.8%
EBIT	4,707	3,291	43.0%	2,325	102.5%
Financial expenses	709	621	14.0%	329	115.7%
- Interest expenses	541	523	3.3%	266	103.4%
Dep. and amortization	1,181	1,139	3.7%	652	81.2%
Non-recurring items (*)					
Extraordinary items (*)					
PBT	4,272	3,096	38.0%	2,161	97.7%
PAT	3,773	2,743	37.5%	1,755	115.0%
(*) Adjusted PAT	3,773	2,743	37.5%	1,755	115.0%

Source: HPG, Rong Viet Securities

Exhibit 2: 3Q2020 Performance Analysis

Particulars	3Q-FY20	2Q-FY20	+/- qoq	3Q-FY19	+/- yoy
Profitability Ratios (%)					
Gross Margin	20.9%	18.1%	280bps	17.9%	303bps
EBITDA Margin	23.9%	21.7%	216bps	19.7%	412bps
EBIT Margin	19.1%	16.1%	295bps	15.4%	366bps
Net Margin	15.3%	13.4%	185bps	11.6%	365bps
Adjusted Net Margin	15.3%	13.4%	185bps	11.6%	365bps
Turnover *(x)					
-Inventories	3.7	3.3	0.4	2.9	0.9
-Receivables	19.6	17.7	2.0	15.1	4.5
-Payables	7.1	7.1	(0.0)	7.1	0.0
Leverage (%)					
Total Debt/ Equity	113.6%	114.2%	-60bps	111.6%	202bps

Source: Rong Viet Securities

Exhibit 3: 4Q2020 Performance Forecast

Particulars (VND Bn)	4Q-FY20	+/- qoq	+/- yoy
Revenue	23,861	-3%	33%
Gross profit	4,512	-13%	59%
EBIT	3,974	-16%	62%
NPAT	3,145	-17%	64%

Source: Rong Viet Securities

Comments:

- Revenue is going to grow by 33% YoY in 4Q owing to an increase of 15% YoY in construction steel selling volume, new HRC capacity and a high steel billet selling volume.

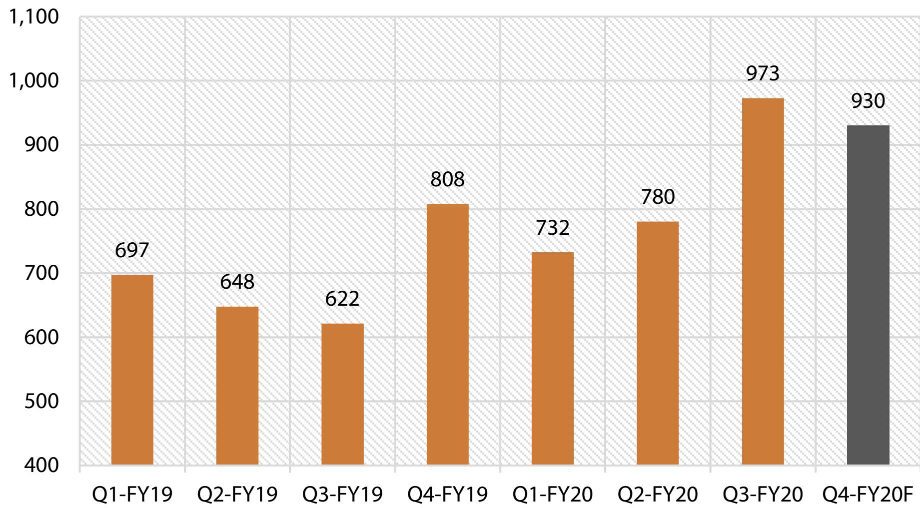
- Gross margin is forecasted to decrease from 20.9% in 3Q to 18.9% in 4Q because production costs increased at a higher pace than selling prices.

- The agriculture segment's NPAT is expected to decrease in 4Q compared to 3Q due to decreasing hog prices in the October-November period.

Update

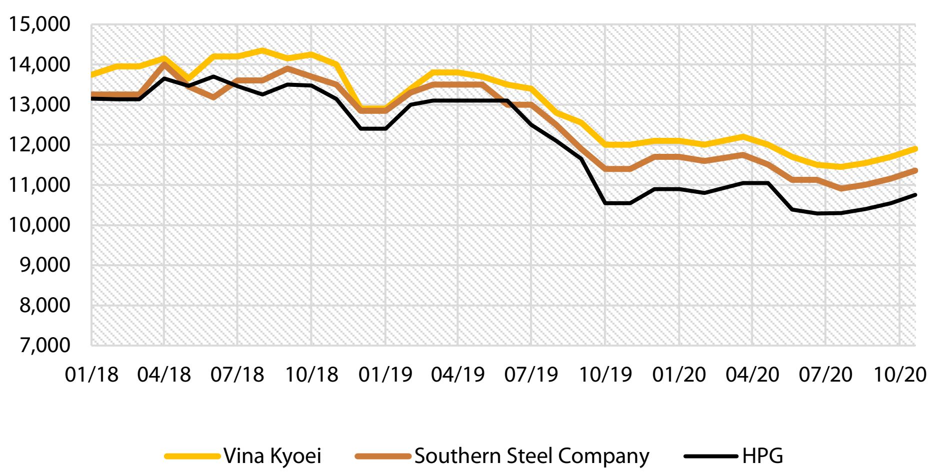
Construction steel selling volume grew strongly in 3Q because of new capacity. HPG's COD of the new blast furnace coincided with the recovery in the construction steel market. Vietnam's construction steel consumption reached 2.74 million tons in 3Q, up 9% YoY. Similarly, the company's selling volume in grew by 57% YoY (figure 1). Besides, although the Southern market's consumption increased by just 3% YoY in 3Q2020, HPG's selling volume doubled. It was attributed to HPG's competitive strategy of maintaining low selling prices (figure 2). Throughout 9M2020, HPG's price was kept at 6% lower than Southern Steel Company's and 10% lower than Vina Kyoei's. For 4Q, we forecast that HPG will sell roughly the same amount of steel as in 3Q.

Figure 1: Finished construction steel sales (thousand tons)



Source: HPG, RongViet Securities

Figure 2: Construction steel prices in the South (VND/kg)



Source: HPG, RongViet Securities

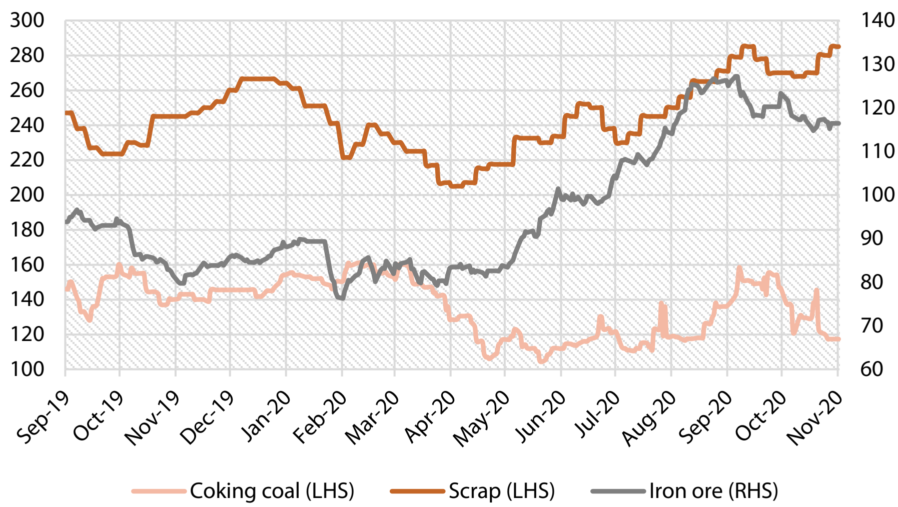
HPG has started producing HRC. HPG's crude steel production volume reached 575,000 tons per month in September, increasing by 19% MoM, as three mills in the Dung Quat steel complex are running at full capacity. Due to the abundant capacity, HPG can maintain a high steel sales volume and supply sufficient slabs to produce 340,000 tons of HRC in 4Q.

Iron ore prices put pressure on the steel segment's gross margin in 4Q2020. The iron ore price has surged from June and hit a peak of roughly USD 130/ton in September (figure 3). The unfavorable iron ore price movement in 3Q will affect HPG's gross margin in 4Q2020 as

HPG's inventory period is maintained at roughly four months. We estimate that steel production costs are likely to change by +10% QoQ in 4Q. Meanwhile, construction steel average selling price (ASP) can only increase by 5% QoQ in 4Q. For 4Q/2020, increasing ASP will moderate the impact from high production costs, leading HPG's gross margin to drop from 20.9% in 3Q to 18.1%.

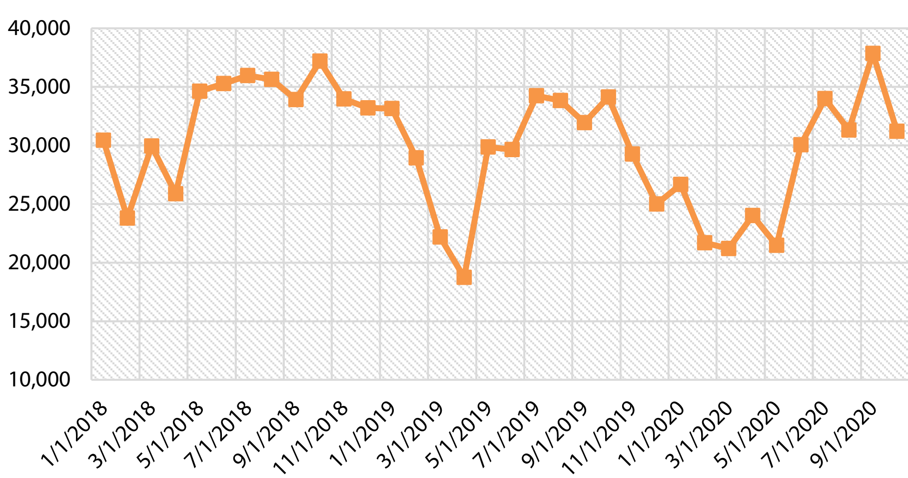
We forecast that iron ore prices will be in a downtrend in 4Q/2020 as mining activities in Brazil have been recovering, given that this country was the second-largest iron exporter in the world. Brazil's iron ore export in September increased 21% MoM to 38 million tons, the highest level since 2015.

Figure 3: Key material prices (USD/ton)



Source: Bloomberg, RongViet Securities

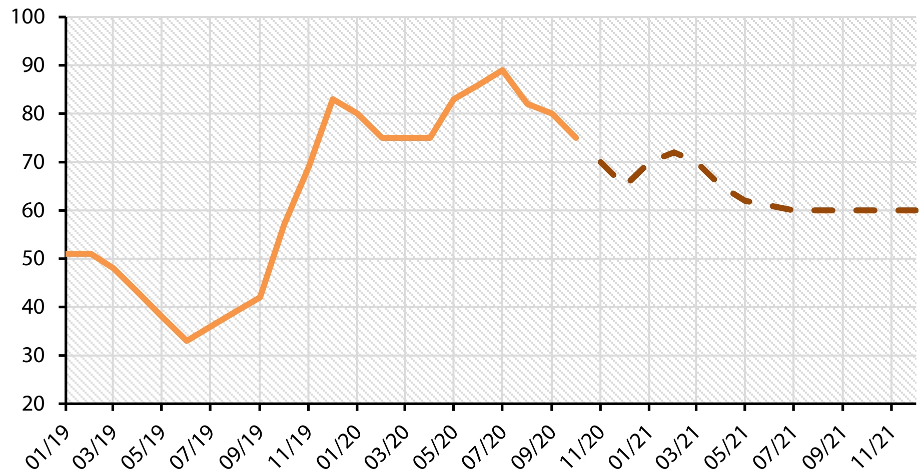
Figure 4: Brazil's monthly iron ore export (thousand tons)



Source: Brazil's Ministry of Industry, Foreign Trade and Services

The agriculture segment's net income is likely to decrease in 4Q compared to previous quarters. According to the General Statistics Office of Vietnam, the number of pigs has increased by 3.6% YoY in September, while hog supply has decreased by 3.2% YoY. Hence, we expect hog production to recover and the supply can meet the demand in 4Q. We assume that hog prices will hit the bottom of VND 65,000/kg in November. Lower hog prices will lower net income from the agriculture segment by 19% from VND 456 billion in 3Q to VND 318 billion in 4Q. However, this segment will still contribute roughly 10% of HPG's net income in 4Q. In the agriculture segment's gross profit structure, hog breeding and cow breeding are estimated to account for 63% and 24% respectively.

Figure 5: Hog price forecast (VND thousand/kg)



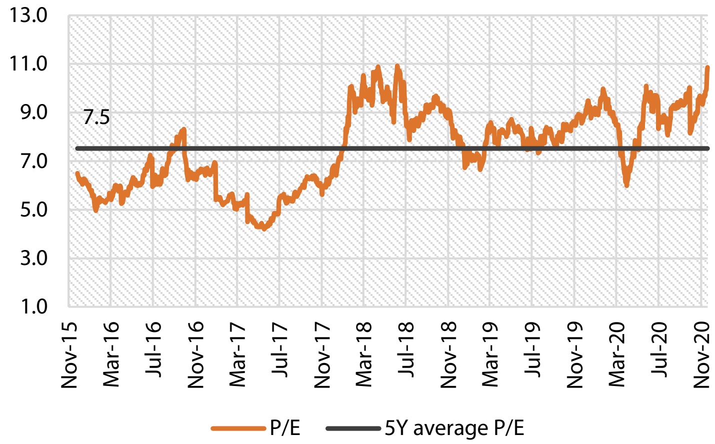
Source: Vietnambiz, RongViet Securities

HPG's net income is forecasted to reach a peak in 3Q and it has been reflected in the stock price performance, hence the neutral upside. We expect that 4Q net income will be lower than 3Q due to the unfavorable steel input and hog price movements as mentioned above. Currently, HPG's P/E ratio 2020 is roughly 10.4x, which we believe is fair. Compared to the five-year average P/E ratio of 7.5x, the current P/E trailing of roughly 10.9x is significantly higher (figure 6). Meanwhile, the P/B trailing of 2.1x has surpassed the five-year average P/B ratio. Besides, HPG's stock price has increased by roughly 90% YTD, considerably higher than VN-index's YTD return of negative 6%. Accordingly, we believe the upside for the remaining of 2020 is limited, hence, short-term investors should consider taking profits.

For longer term investors, HPG is still a good stock as we estimate its intrinsic value is roughly VND 40,100 per share, based on the FCFF method. As Dung Quat is rushing to COD its fourth and final blast furnace, this mill running at full capacity since the beginning of 2021 will enable HPG to achieve a strong volume growth for the whole year. Accordingly, we estimate that HPG is going to be capable of making eight million tons of crude steel annually. It is equivalent of nearly 670,000 tons per month, 16% higher than the current capacity. On a preliminary assessment, an improvement in capacity can be the strongest growth driver that a steel maker can thrive on. We also want to remind investors of a precedent achievement that HPG has done in the 2015-2016 period. In particular, its third blast furnace at Hai Duong steel complex improved its total construction steel capacity by more than 30% in 2016 and HPG nearly doubled its NPAT during the year. To sum up, we emphasize HPG's vast potential and we think there is still ample upside for long-term shareholders.

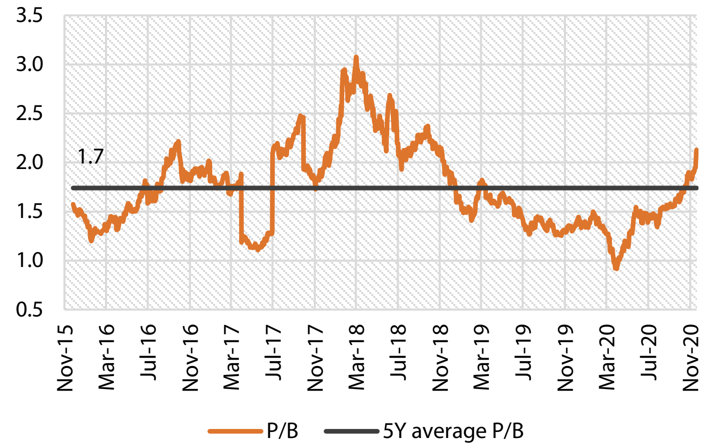
We will determine the target price for 2021 as soon as the commodity price assumptions become more reliable. As mentioned above, iron ore and HRC prices have been fluctuating a lot, which makes it difficult to determine the starting point for 2021. Therefore, we will update our HPG's 2021 performance forecasts in the next few months when we can reliably estimate HPG's inventory costs for 2021.

Figure 6: HPG's historical P/E ratio



Source: HPG, RongViet Securities

Figure 7: HPG's historical P/B ratio



Source: HPG, RongViet Securities

VND Billion

INCOME STATEMENT	FY2018	FY2019	FY2020F	FY2021F
Revenue	55,836	63,658	88,201	104,059
COGS	44,166	52,473	71,052	82,870
Gross profit	**11,671**	**11,185**	**17,150**	**21,189**
Selling Expenses	679	873	1,111	1,415
G&A Expenses	442	569	714	1,199
Finance Income	294	471	818	556
Finance Expenses	772	1,182	2,604	2,670
Other profits	-1	66	83	83
PBT	**10,071**	**9,097**	**13,619**	**16,543**
Prov. of Tax	1,471	1,518	1,629	1,865
Minority Interest	28	71	0	0
PAT to Equity S/H	**8,573**	**7,508**	**11,990**	**14,678**
EBIT	10,550	9,743	15,324	18,575
EBITDA	12,834	12,381	21,111	24,434

FINANCIAL RATIO	FY2018	FY2019	FY2020F	FY2021F
Growth (%)				
Revenue	21.0	14.0	38.6	18.0
Operating Income	10.3	-3.5	70.5	15.7
EBITDA	9.6	-7.6	57.3	21.2
PAT	7.1	-12.4	59.7	22.4
Total Assets	49.2	29.5	10.3	1.3
Equity	25.4	17.6	32.4	11.4
Profitability (%)				
Gross margin	20.9	17.6	19.4	20.4
EBITDA margin	23.0	19.4	23.9	23.5
EBIT margin	18.9	15.3	17.4	17.9
Net margin	15.4	11.8	13.6	14.1
ROA	11.0	7.4	10.8	13.0
ROE	21.2	15.8	19.0	20.9
Efficiency				(times)
Receivable Turnover	14.3	17.8	12.9	12.2
Inventory Turnover	3.1	2.7	3.1	3.1
Payable Turnover	3.7	5.6	8.2	5.9
Liquidity				(times)
Current	1.1	1.2	1.8	2.0
Quick	0.5	0.4	0.8	0.9
Finance Structure (%)				
Total Debt/Equity	60.0	77.1	51.5	35.2
Current Debt/Equity	28.4	35.4	24.8	15.9
Long-term Debt/Equity	31.6	41.7	26.8	19.2

VND Billion

BALANCE SHEET	FY2018	FY2019	FY2020F	FY2021F
Cash and cash equivalent	2,516	4,565	4,370	6,188
Short-term investments	3,725	1,374	7,559	6,047
Account receivable	3,915	3,575	6,828	8,505
Inventories	14,115	19,412	22,966	26,641
Other current assets	1,743	1,546	1,855	2,226
Property, plant & equipment	49,944	68,242	65,201	60,287
Acquired intangible assets	305	331	315	299
Long-term investments	67	26	24	23
Other non-current assets	1,690	1,971	2,286	2,652
Total assets	**78,019**	**101,041**	**111,405**	**112,868**
Account payable	12,029	9,340	8,703	13,943
Short-term borrowings	11,495	16,838	15,604	11,175
Long-term borrowings	12,811	19,842	16,866	13,493
Other non-current liabilities	506	7,163	5,730	2,292
Bonus and welfare fund	775	820	1,310	1,603
Technology-science, dev. fund	0	0	0	0
Total liabilities	**37,616**	**54,003**	**48,214**	**42,507**
Common stock and APIC	24,451	30,822	36,335	36,335
Treasury stock (enter as -)	0	0	0	0
Retained earnings	15,111	15,858	25,749	32,919
Other comprehensive income	0	1	1	1
Inv. and Dev. Fund	919	924	924	924
Total equity	**40,481**	**47,605**	**63,008**	**70,179**
Minority Interest	**128**	**183**	**183**	**183**

VALUATION RATIO (*)	FY2018	FY2019	FY2020F	FY2021F
EPS (VND)	3,794	2,556	3,402	4,164
P/E (x)	7.7	8.6	10.4	8.5
BV (VND)	12,218	14,368	19,017	21,181
P/B (x)	1.6	1.4	1.9	1.7
DPS (VND/cp)	0	0	500	2,000
Dividend yield (%)	0.0	0.0	1.4	5.6

VALUATION MODEL	*Price*	*Weight*	*Average*
FCFF	40,100	40%	16,025
P/E (7.5x)	25,600	30%	7,673
P/B (1.7x)	33,100	30%	9,925
Target price (VND)			**33,600**

VALUATION HISTORY	*Price*	*Recommendation*	*Period*
16/01/2020	33,400	BUY	Intermediate
20/03/2020	22,300	BUY	Intermediate
28/08/2020	29,400	BUY	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%

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