RONG VIET SECURITIES

# STEEL INDUSTRY: Industry Restructuring Ahead

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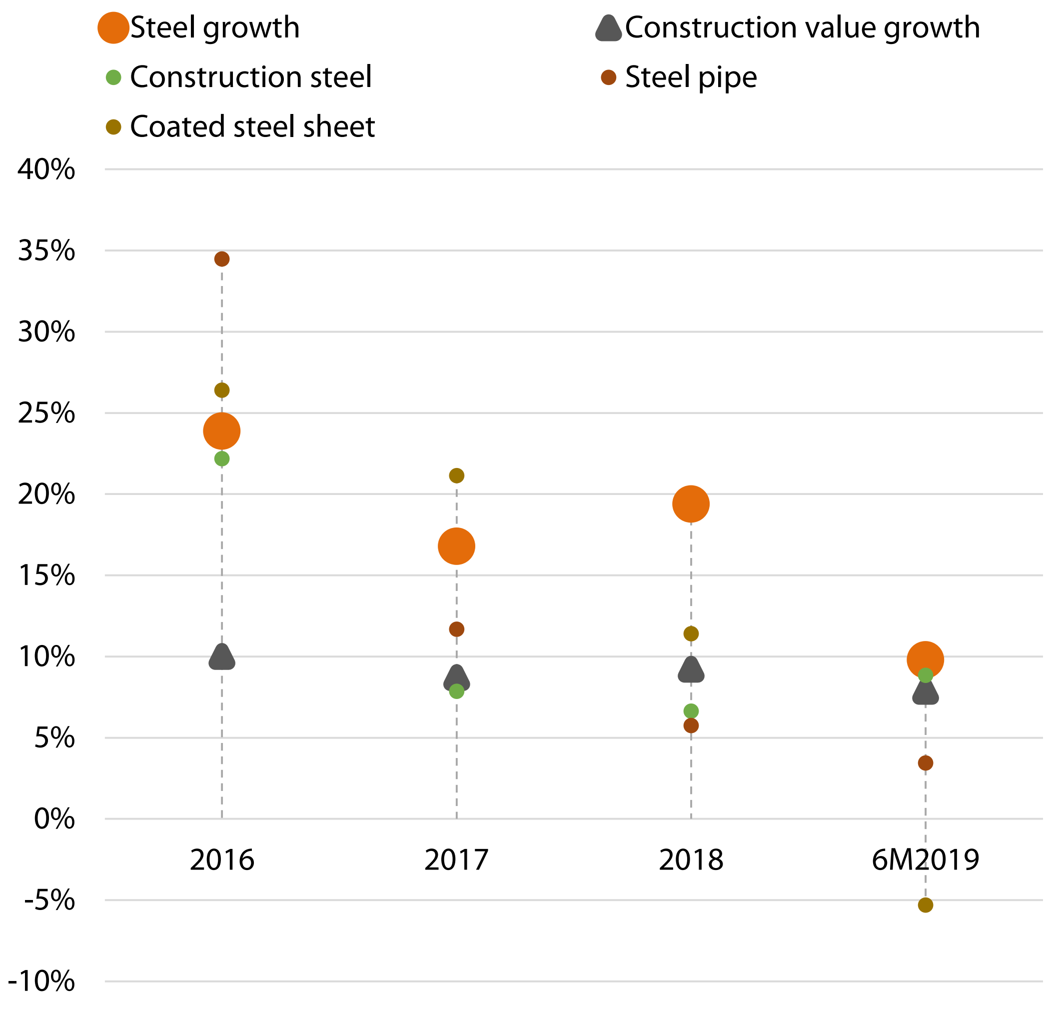
## Unfavorable conditions from the construction industry

**Figure 1: Industry growth**




*Source: VSA, GSO, RongViet Securities*

- Construction value growth slowed down to 7.9% in 6M2019 and affected steel demand.
- The steel industry sold 11.6 million tons in 1H2019, 9.8% higher YoY. However, the main growth driver was HRC sales due to low based 6M2018. Construction steel and steel pipe grew at a moderate pace while coated steel sheet products saw a negative -5%.
- Growth rates differentiated among product groups:
  - ➢ Construction steel followed the construction industry's growth closely.
  - ➢ Steel pipe grew at a lower rate.
  - ➢ Coated steel sheet faced difficulty, seeing a negative growth of 5%, mostly due to a 19% reduction in exports.
- Hot rolled coils grew 45% YoY owing to Formosa Ha Tinh. The Taiwanese FDI is currently running two BOFs and capable of around 6 million tons of HRC per annum. The supplier will be joined by HPG, who is setting up 2 BOFs for HRC production, total 3.5 million tpy.

## Hiking iron ore price puts pressure on profit margin

**Iron ore's surge has yet to cool down**

- Iron ore price has gained 91% YoY due to the mining incident in Brazil. The price averaged USD 66 per ton in 2018 but peaked at USD 125 per ton in July, the 5-year high.
- Iron ore makes up one-third of BOF's production cost. The price hike created pressure on BOF profitability including most Chinese producers and HPG.

**Sale prices, meanwhile are under pressured due to weak global demand**

- Weak global demand prevents steel prices, especially HRC, from recovering.
- Mid- and down-stream producers bear the most impact. Most Vietnamese producers are operating down-stream and suffered from loss during the last few quarters.
- Long steel prices have been weak as well, impacting almost every steel companies' profit.

**Figure 2: Global steel prices**

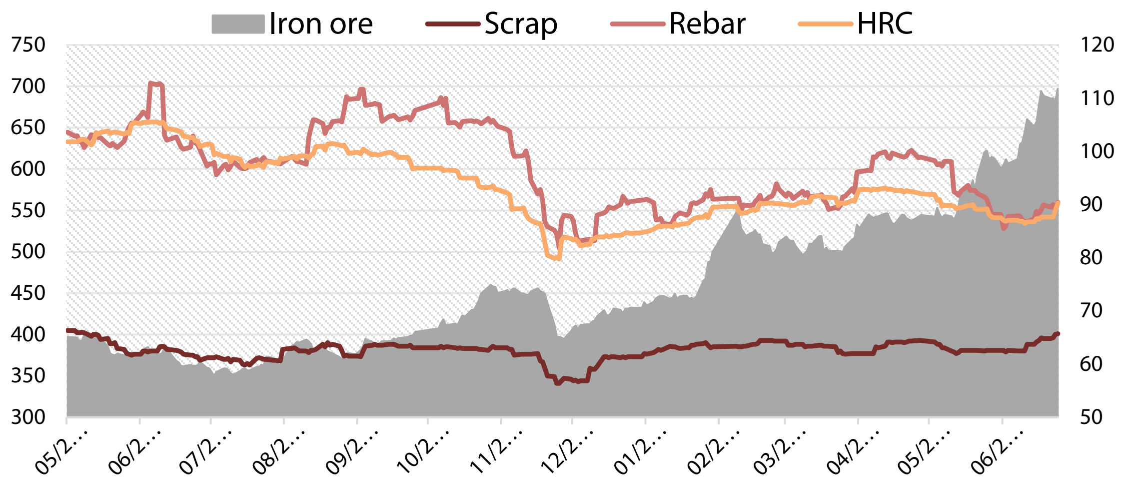
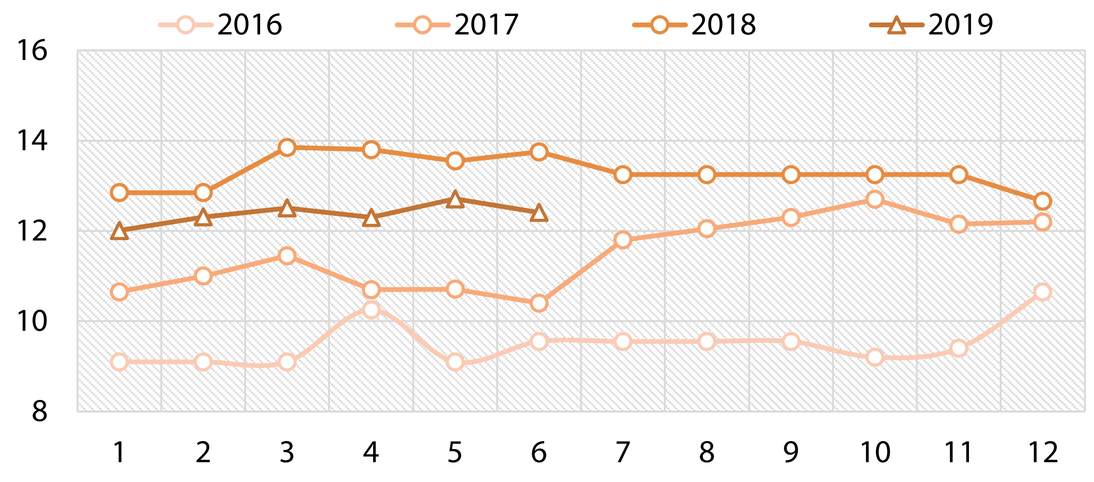



**Figure 3: Vietnam wire rod price**




*Source: VSA, GSO, RongViet Securities*

## Markets become highly concentrated

- Construction steel segment sees HPG's dominance, which is expected to continue when Dung Quat starts operation.
- HPG also leads the steel pipe market while HSG falls behind.
- Ton Dong A is accelerating in the coated steel sheet market, surpassing NKG while HSG maintains sole leadership in retailing.

**Figure 4: Construction steel**

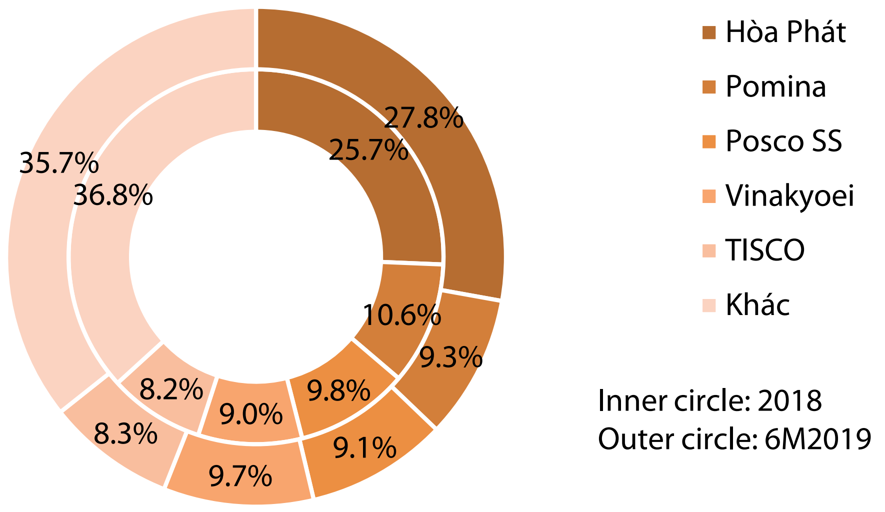



**Figure 5: Steel pipe**

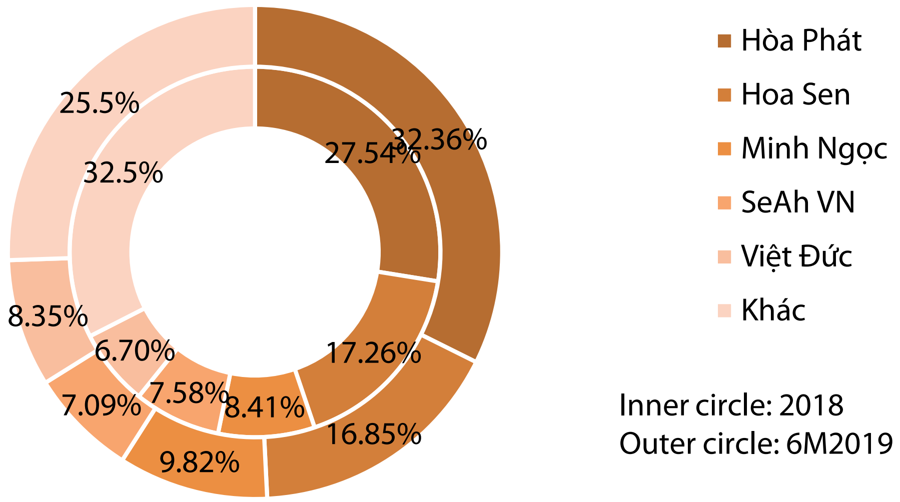
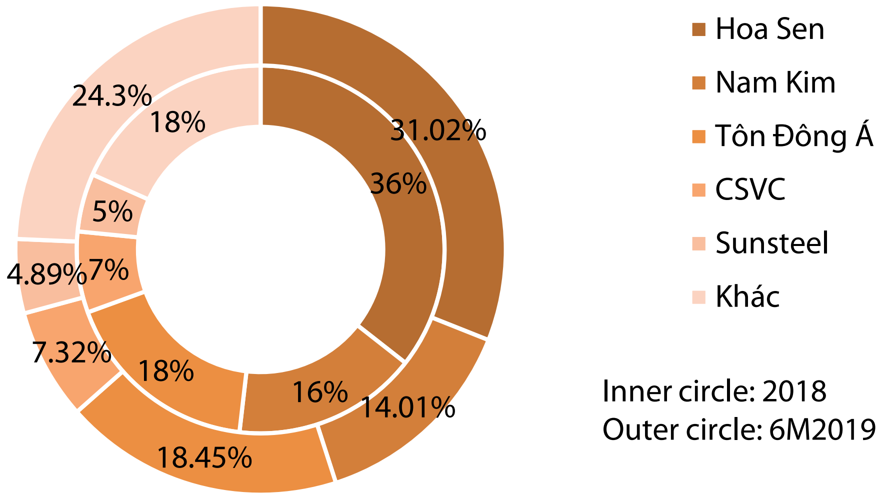



**Figure 6: Coal steel**




*Source: VSA, RongViet Securities*

## 2019 might be another restructuring year

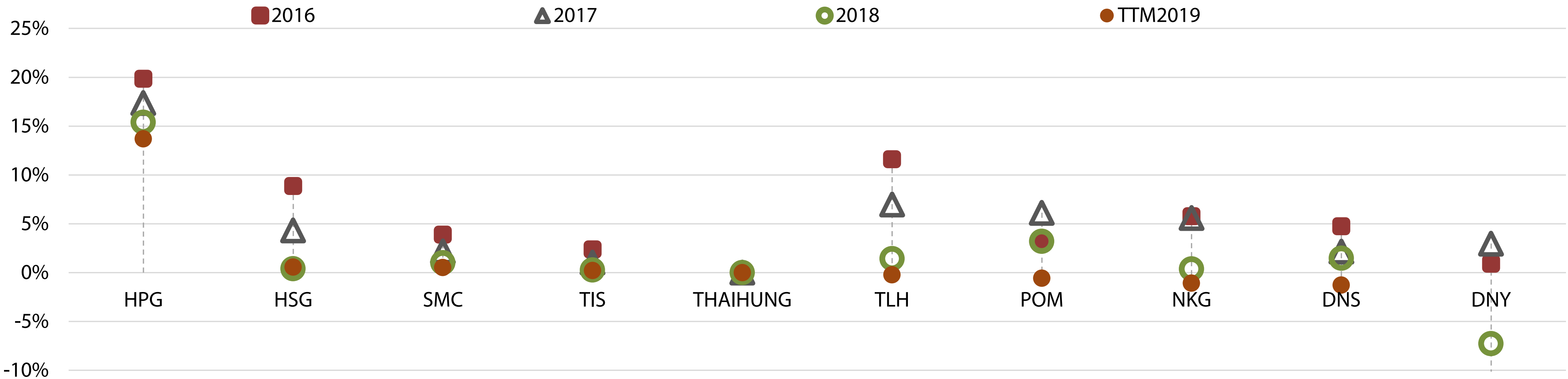
**Deteriorating margins are the main concern**

- Weak prices are causing problems to all market participants, even large firms suffer.
- Inefficient steel mills might be driven out of business if the situation prolongs.

**Pressures from banks limit speculative activities**

- Speculating is discouraged to firms with already high leverage.

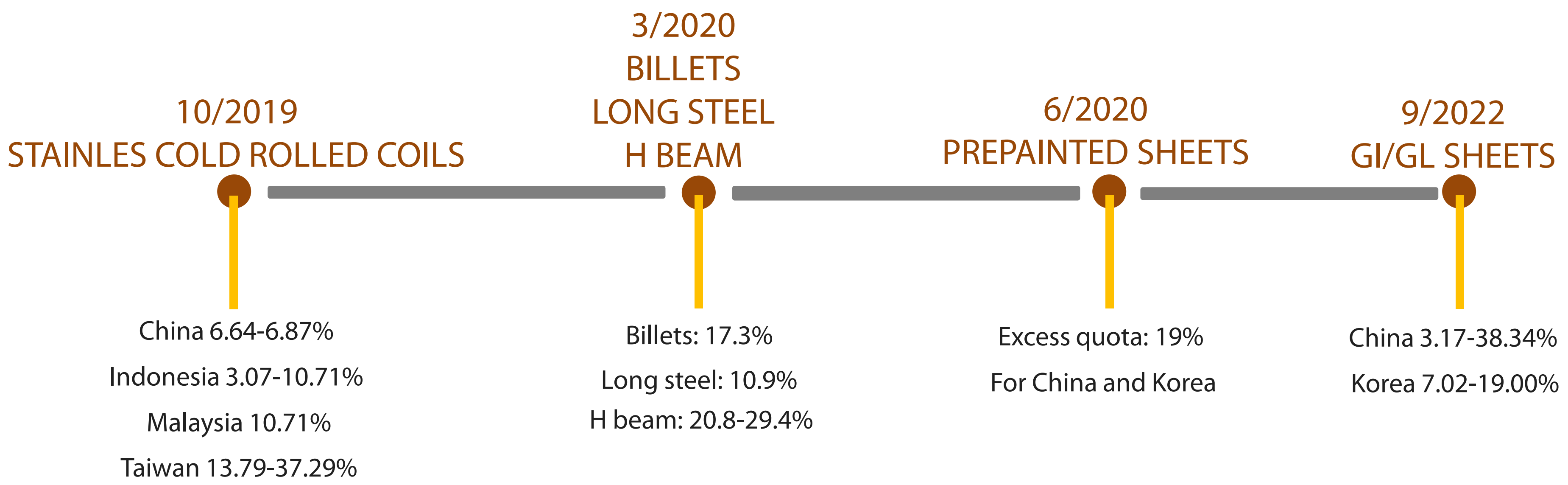
**Figure 7: Major steel companies' net margins**




*Source: VSA, GSO, RongViet Securities*

## Trade policies continue to be an important factor

**Figure 8: Antidumping and Countervailing review timeline**




**The continuity of trade protection is critical to local firms' profitability**

- Generally all duties are expected to be renewed. Trade protection is likely to continue until China resolves its oversupply problems.
- Tariff is considered crucial especially for downstream producers.

**HRC tariff might be initiated, following global trend**

- Formosa & HPG' capacity altogether will be sufficient for domestic consumption by 2021. As the domestic flat steel market is self-sufficient, the government is going to impose tariff to protect the local supply side, which is precedented by the AD duties on billets and rebar in 2016.
- In short, Vietnamese steel producers will continue to benefit from the protection trends, especially those who focus on the domestic market.

*Source: RongViet Securities*

## Domestic market will be the main growth driver, given difficulties in export markets

**Table 1: Antidumping and Countervailing on Vietnamese steel**

| Country | Product | Duty | Proportion in Vietnam's export value 2018 | Duration |
|---|---|---|---|---|
| **Thailand** | Prepainted sheets<br>Galvalume sheets | 4.3% - 60.26%<br>6.2% – 40.49% | 4% | 2017-2022 |
| **Indonesia** | Prepainted sheets | 12.01%-28.49% | 7% | 2018- terminated |
| **Malaysia** | Galvanized sheets<br>Cold rolled coils | 2.66%-15.69%<br>(Hoa Sen 0%. Nam Kim 2.66%) | 9% | 2019-2024 |
| **EU** | Cold rolled coils<br>GI/GL<br>Stainless cold rolled coils | 25% for exceeding quota | 11% | 2018-2019 |
| **Canada** | Carbon steel pipe | 3%-54.2% | 1% | 2018-2019 |
| **Brazil** | Stainless steel pipe | 17.72%-53.92% | 4% | N/A |
| **Australia** | Rod in coils | Negative dumping | 2% | None |
| **U.S.** | Stainless steel from China<br>Cold rolled coils | 199.76% + 256.44%<br>199.43% + 39.05% | 7% | N/A |

*Source: VSA, GSO, RongViet Securities*

**The continuity of trade protection is critical to local firms' profitability**

- 45% export volume is subjected to trade protections.
- Many exporters aim to shift focus back to the local market where room to growth is still ample.

## Industry comparables (TTM)

| Ticker | Sales Growth (%) | EBITDA Growth (%) | EBITDA Margin | Operating Income Margin | Net Income Growth (%) | Net Profit Margin | Capex/Sales (%) | Return on Invested Capital | Return on Assets | Return on Equity |
|---|---|---|---|---|---|---|---|---|---|---|
| **HPG** | 11,6 | -3,6 | 21,3 | 17,3 | -10,2 | 13,7 | 49,4 | 12,9 | 10,4 | 19,9 |
| **HSG** | -7,8 | -25,8 | 6,3 | 2,5 | -95,0 | 0,1 | 7,9 | 2,4 | 0,2 | 0,7 |
| **POM** | 0,9 | -69,2 | 3,1 | 1,4 | -80,9 | -0,6 | 15,5 | 1,7 | -0,8 | -2,1 |
| **NKG** | -14,4 | -70,6 | 3,1 | -0,3 | N/A | -1,1 | 2,9 | -0,9 | -1,5 | -4,5 |
| **SMC** | 15,8 | N/A | N/A | 1,5 | -60,2 | 0,6 | 1,7 | 5,2 | 1,8 | 7,7 |
| **TLH** | -5,5 | -80,1 | 1,8 | 1,2 | -92,8 | -0,2 | 0,4 | 1,7 | -0,2 | -0,5 |
| **VGS** | 5,3 | -43,6 | 1,4 | 1,1 | -51,9 | 0,5 | 0,5 | 4,6 | 2,2 | 5,9 |
| **DNY** | -69,5 | -86,5 | -13,7 | -33,9 | N/A | -40,4 | 4,1 | -18,8 | -16,6 | -113,4 |

*Source: Bloomberg, RongViet Securities*

# HPG – 2019 IS A STEPPING STONE TO LONG-TERM PROSPERITY

## INVESTMENT RATIONALES

- **Remarkable growth potential in 2020-2021 is derived from internal development**
  - HPG' s steel output is forecasted to increase by 25% in 2019 and 30% in 2020, capable of taking over 30% domestic market share for construction steel owing to new mill Dung Quat
  - When operating at full capacity, Dung Quat can achieve higher efficient than HPG's current steel mill. Therefore, HPG can strengthen its overall profitability and pricing power.
  - New product line- HRC is going to add substantial value to HPG's flat steel business (steep pipe & coated steel sheet). We also anticipate a feasible trade protection as soon as Vietnam become HRC self-sufficient (Formosa & HPG' capacity surpasses 10 million tpy).
- **Short-term input price fluctuations create a low base**
  - Iron ore price rallied, which is disproportionate to the actual impact of the change in supply. Therefore, we expect iron ore price to go south in the future, given the current demand.
  - In exchange of the rising iron ore price, coking coal price remained low, partially offsetting the iron ore hike's impact.
- **Despite heavy Capex demand, HPG maintains its healthy financials**
  - Construction in progress for Dung Quat can be fully disbursed in 2019. It implies that HPG can start debt payment since 2020.
  - Cash dividend might be available in 2020 even though Dung Quat will not have operated fully by then. This shows HPG's stable operating cash flows provided by the existing mills.

## RISKS TO OUR CALLS

- Stronger input price changes with unmatched sale price adjustments.
- Possible oversupply of the coated steel sheet market, which is highly dependent on exports.

## BUY +29%

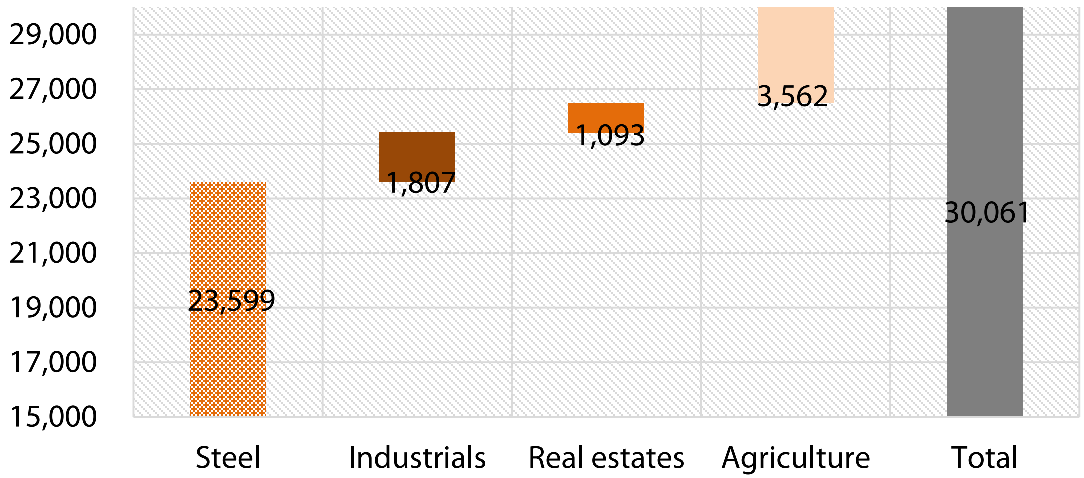
| | |
|---|---|
| CMP (VND) | **23,050** |
| Target price (VND) | **29,700** |
| *Cash dividend in 12 months* | *1,000* |

| STOCK INFO | |
|---|---|
| Sector | Materials |
| Market Cap ($ mn) | 2,731.4 |
| Current Shares O/S (mn shares) | 2,761.1 |
| 3M Avg. Volume (K) | 5,773.5 |
| 3M Avg. Trading Value (VND Bn) | 136.8 |
| Foreign Ownership (%) | 38.3 |
| State Ownership (%) | - |

| FORECAST | 2017A | 2018A | 2019F | 2020F |
|---|---|---|---|---|
| **Revenue** | 46,162 | 55,836 | 67,968 | 88,537 |
| *Growth (%)* | 38.7 | 21.0 | 21.7 | 30.3 |
| **NPATMI** | 8,007 | 8,573 | 8,612 | 12,876 |
| *Growth (%)* | 21.3 | 7.1 | 0.5 | 49.5 |
| ROA (%) | 15.3 | 11.0 | 10.0 | 12.9 |
| ROE (%) | 24.8 | 21.2 | 20.4 | 23.7 |
| EPS (VND) | 2,714 | 2,919 | 2,932 | 4,384 |
| Book Value (VND) | 21,282 | 19,060 | 15,282 | 19,666 |
| Cash dividend (VND) | 0 | 1,500 | 0 | 1,000 |
| P/E (x) | 8.9 | 7.7 | 7.9 | 5.3 |
| P/B (x) | 1.6 | 1.6 | 1.5 | 1.2 |

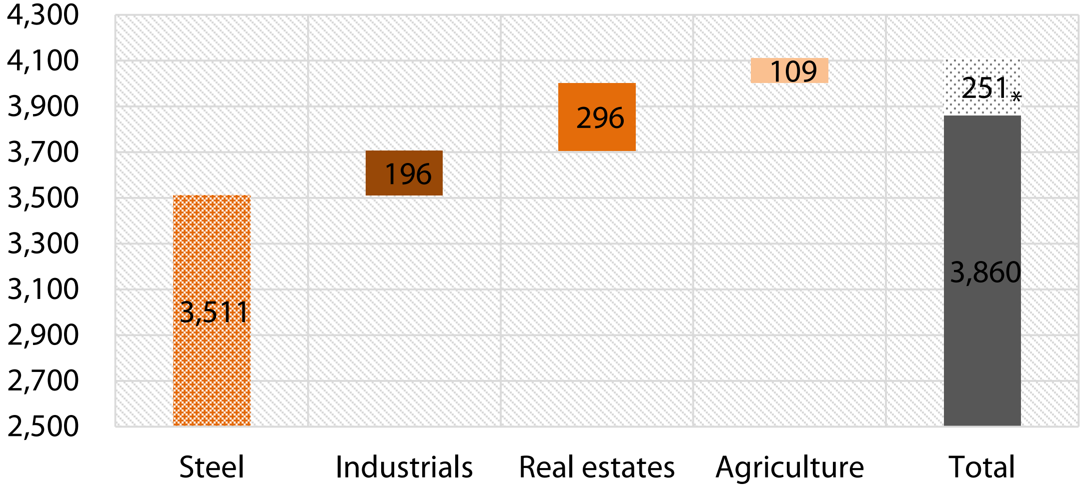
# HPG – 1H2019 net profit impacted by surging iron ore price

**Figure 1: 1H 2019 revenue per segment (VND bn)**




*Source: HPG, RongViet Securities*

**Figure 2: 1H 2019 NPAT per segment (VND bn)**




*Source: HPG, Rong Viet Securities. (*) is Parent company minus Intercompany elimination*

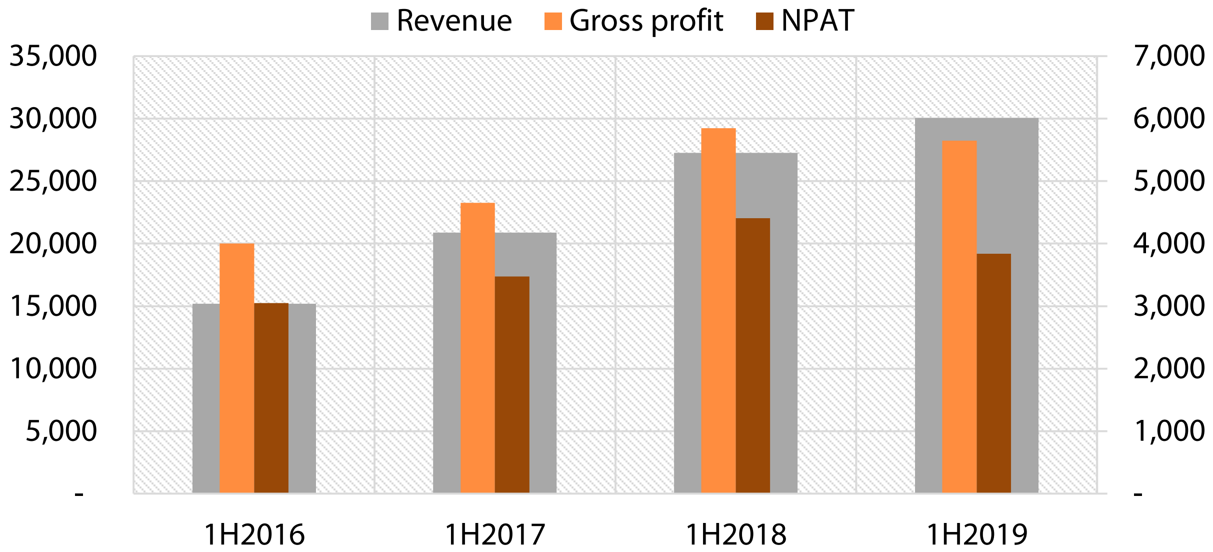
### Sales met expectations, but profit did not due to iron ore price hike

- Construction steel volume +23% yoy, steel pipe volume +16% yoy. HPG are leading both industries in terms of market shares.
- HPG's used iron ore price averaged USD 90 per ton during 6M2019 (planned price USD 75 per ton), impacting gross margin.

### Dung Quat's construction keeps on track

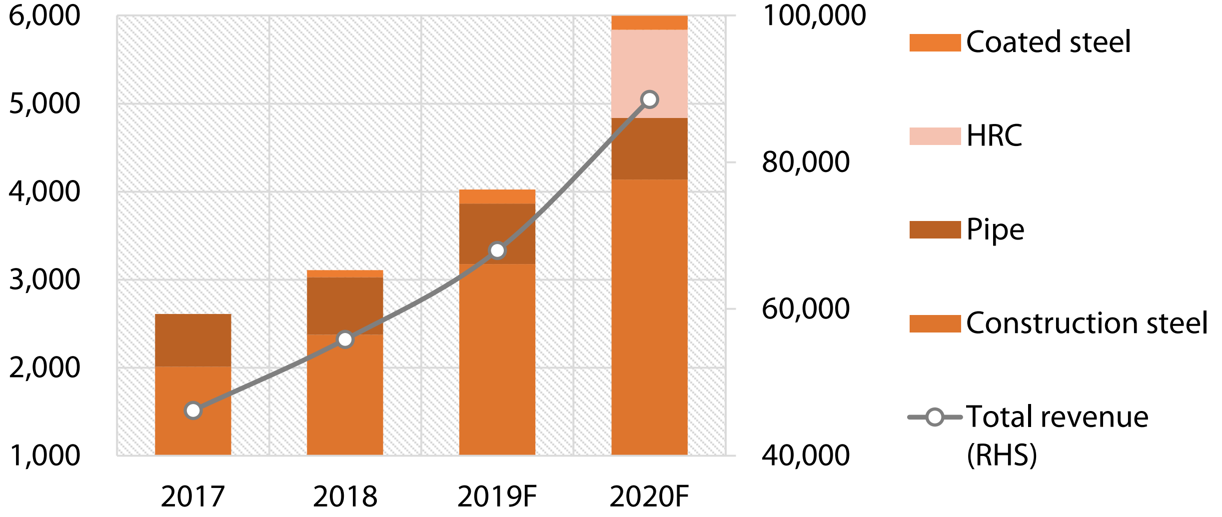
- The first BOF operated in July.
- HRC line is scheduled to start operation in March 2020.

**Figure 3: 1H 2019 Revenue and NPAT (VND bn)**



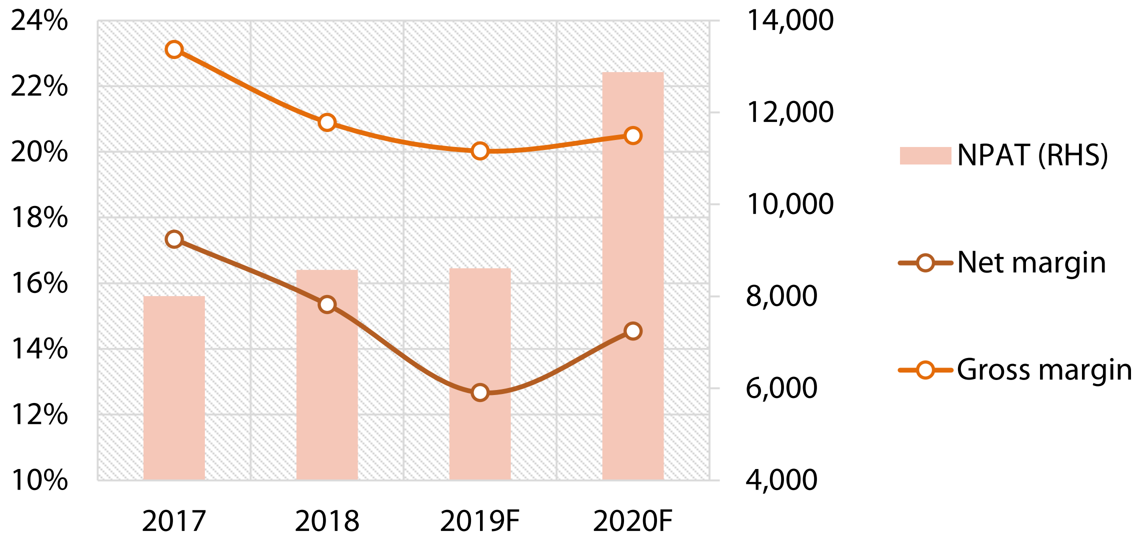

*Source: HPG, RongViet Securities*

**Figure 4: Volume (thousand tons) and revenue (VND bn) forecast**




*Source: Rong Viet Securities*

**Figure 5: Profitability and net profit (VND bn) forecast**




*Source: Rong Viet Securities*

**2H2019 may continue to suffer the impact of the hiking iron ore price**

- Main assumptions include: local rebar price VND 12,600 per kg, HRC price USD 526 per ton, iron ore USD 94 per ton.
- Volume is forecasted at +29% yoy, mostly from the construction steel segment.
- Gross margin is forecasted to reduce to 20% while net margin might bottom at 12.7% because of higher interest expense. The bottom-line figure is estimated at VND 8,612 billion, flat compared to 2018.

**Other segments can stabilize their performances. However, their contributions to the consolidated are increasingly minimalized due to the strong expansion of the steel business**

- Agriculture and industrial parks have been growing strongly with promising potentials in 2020-2021. However, because the steel business is going to expand by several times in size, the other segments' contribution becomes increasingly unimportant.
- We expect that HPG might establish new businesses that support its steel value chain, e.g. cargo transport.

# HSG – HRC PRICE FLUCTUATIONS IMPACT PROFITABILITY

## INVESTMENT RATIONALES

- **Nevertheless, HSG has the ultimate advantage in retailing as the leader of the coated steel industry.**
  - HSG operates over 500 retailers and has production plants nationwide.
  - Having a well-perceived brand name for coated steel sheets, steel pipes and plastic pipes, HSG can enjoy higher margins because of its pricing power against both consumers and rivals.
  - HSG has the capacity to seize opportunities both at home and overseas.
- **A turnaround story is feasible.**
  - Should HSG focuses on improving its core business and restraining speculative activities, its profitability can be stabilized.
  - We reckon that HSG's major weakness is financials. Since its core business has an established advantage, revamping financial health is going to elevate the market sentiment on the stock.

## RISKS TO OUR CALLS

- **Corporate governance overshadows potential.**
  - Transactions with related parties takes up xx% of total revenue, causing concern.
  - Speculative activities are difficult to track.
- **HRC price fluctuations impact HSG's gross margin significantly.**
- **Excessive borrowings incur burdening interest expense, harming the bottom-line.**

## 2019FY Guidance

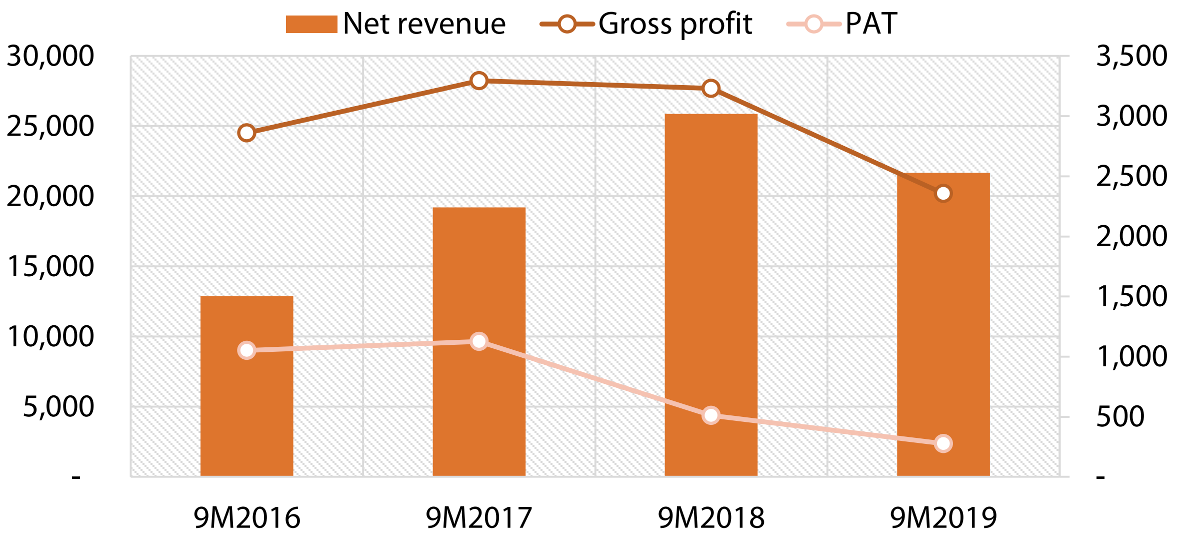
| | |
|---|---|
| Revenue growth | **+9%** |
| Profit growth | **+22%** |

| STOCK INFO | |
|---|---|
| Sector | Materials |
| Market Cap ($ mn) | 120.6 |
| Current Shares O/S (mn shares) | 423.3 |
| 3M Avg. Volume (K) | 2,272.2 |
| 3M Avg. Trading Value (VND Bn) | 17.5 |
| Foreign Ownership (%) | 17.5 |
| State Ownership (%) | 0.0 |

| FINANCIALS | 2015A | 2016A | 2017A | 2018A |
|---|---|---|---|---|
| **Revenue** | 17,447 | 17,886 | 26,148 | 34,441 |
| *Growth (%)* | 16.4 | 2.5 | 46.2 | 31.7 |
| **NPATMI** | 653 | 1,501 | 1,331 | 410 |
| *Growth (%)* | 59.1 | 129.9 | -11.3 | -69.2 |
| ROA (%) | 6.9 | 12.2 | 6.2 | 1.9 |
| ROE (%) | 22.4 | 36.4 | 26.1 | 8.0 |
| EPS (VND) | 1,696 | 3,546 | 3,144 | 969 |
| Book Value (VND) | 6,876 | 9,748 | 12,041 | 12,085 |
| Cash dividend (VND) | 357 | 595 | 464 | 413 |
| P/E (x) | 23.7 | 11.3 | 7.2 | 6.2 |
| P/B (x) | 1.4 | 2.1 | 1.7 | 0.5 |

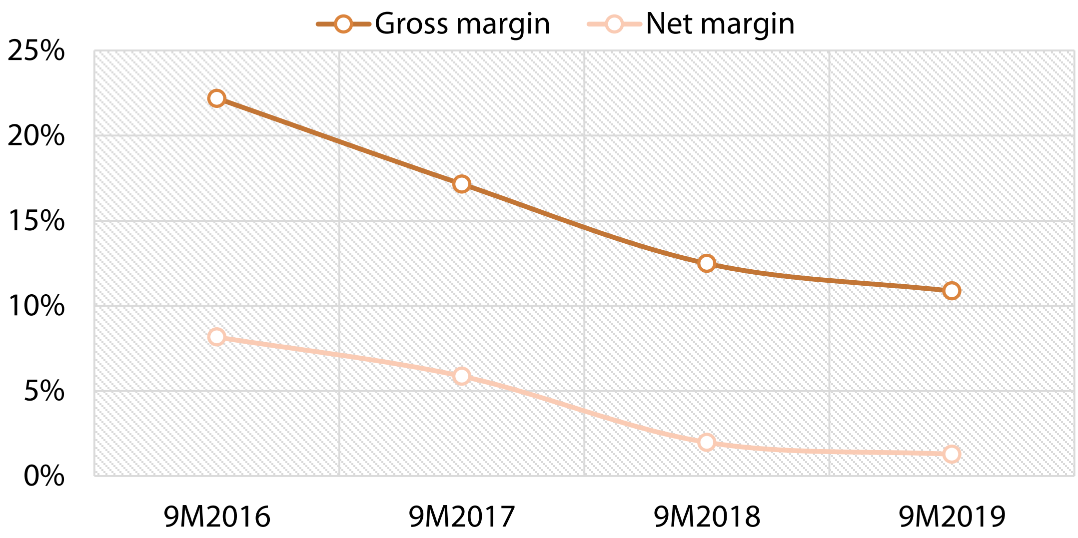
# HSG – 9M2019FY have just broken even

**Figure 1: 1H 2019 revenue (LHS) and gross profit & NPATMI (RHS) in VND bn**




*Source: HSG, Rong Viet Securities*

**Figure 2: Gross and net margins**




*Source: HSG, Rong Viet Securities*

**9M2019FY was strongly hit because of the drop in HRC price**

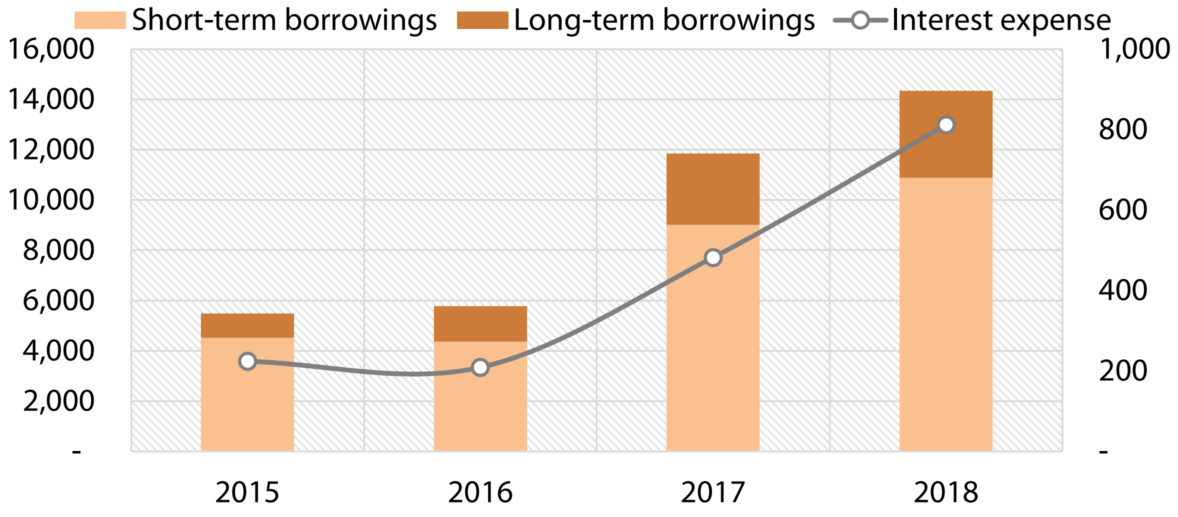
- Sale volume was 861,000 tons of coated steel sheets, -12% yoy; 281,000 tons of steel pipe, -11% yoy. Gross margin reduced to 10.9% because HRC price fluctuated strongly during the period.
- 9M2019FY would have just broken even without one-off incomes from selling land use rights (VND 258 billion pretax profit).
- Quarterly interest expense reduced because of lowered debt levels, but still puts pressures on the bottom-line. TTM interest coverage ration shrank to <1x.

**The rest of the financial year is still highly uncertain as HRC price remains weak.**

- HRC went from ~USD 520 per ton to ~USD 480 during July and August, which is going to affect 4Q's profitability.
- Reducing debts remains one of the major solutions for HSG to revamp financial health.

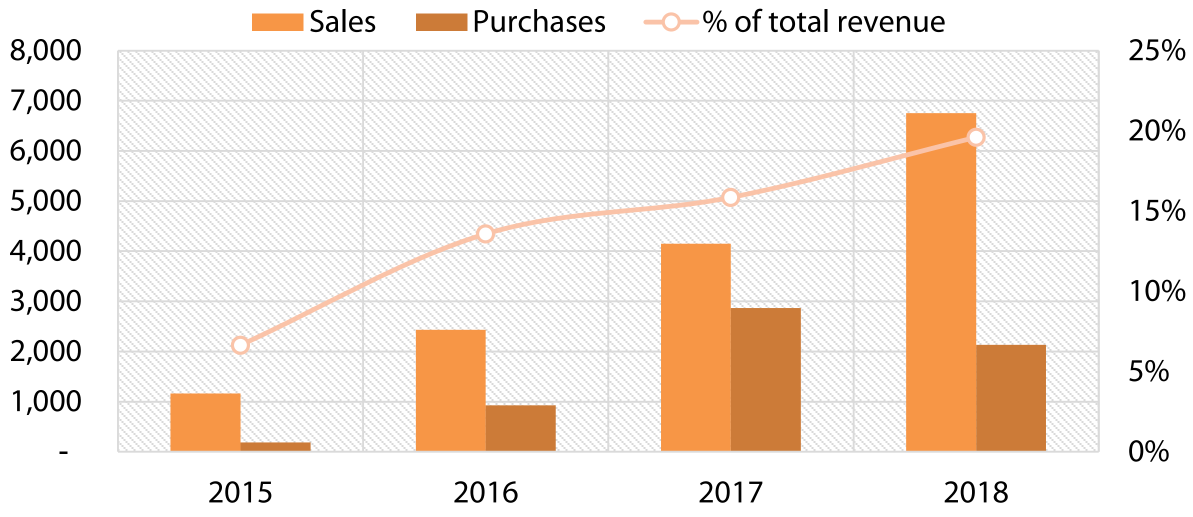
# HSG – 9M2019FY have just broken even

**Figure 3: Debts and interest expense (VND bn)**




*Source: HSG, Rong Viet Securities*

**Figure 4: Transactions with related parties**




*Source: HSG, Rong Viet Securities*

**Restraining transactions with related parties is one of the key plan to revamp corporate governance.**

- Transactions with Chairman's companies accounted for 20% of HSG's total revenue, which ignites our concern over HSG's corporate governance.
- Even though HSG's management announced that they are restricting these transactions, investors should look into the issue to understand fully HSG's business structure.

**We expect HSG to focus more on reducing inventory, paying debts and improving the bottom-line in the intermediate term.**

# NKG – GROWTH VERSUS SUSTAINABILITY

## INVESTMENT RATIONALES

- **NKG is among leading coated steel firms with large capacity and high value-added.**
  - NKG's total capacity exceeds 1 million tpy of coated steel sheets and more than 200,000 tpy of steel pipe.
  - NKG's cold-rolling capacity is self-sufficient, which means it has higher added value than most rivals.
  - NKG can seize opportunities to export owing to high-quality production lines, becoming less dependent on the domestic market.

## RISKS TO OUR CALLS

- **NKG's profit is highly dependent on HRC price.**
  - NKG mostly trades with wholesalers, which mean it has to accept lower margins and be constantly under negotiation pressures from buyers.
  - HRC price fluctuations are often fully reflected in NKG's margin without passthrough. Therefore, unfavorable input price conditions can cause losses to the firm .
- **NKG has excessive debts, both short and long-term, impacting the bottom-line.**

## 2019FY Guidance

| | |
|---|---|
| Revenue growth | **+4%** |
| Profit growth (*) | **+418%** |

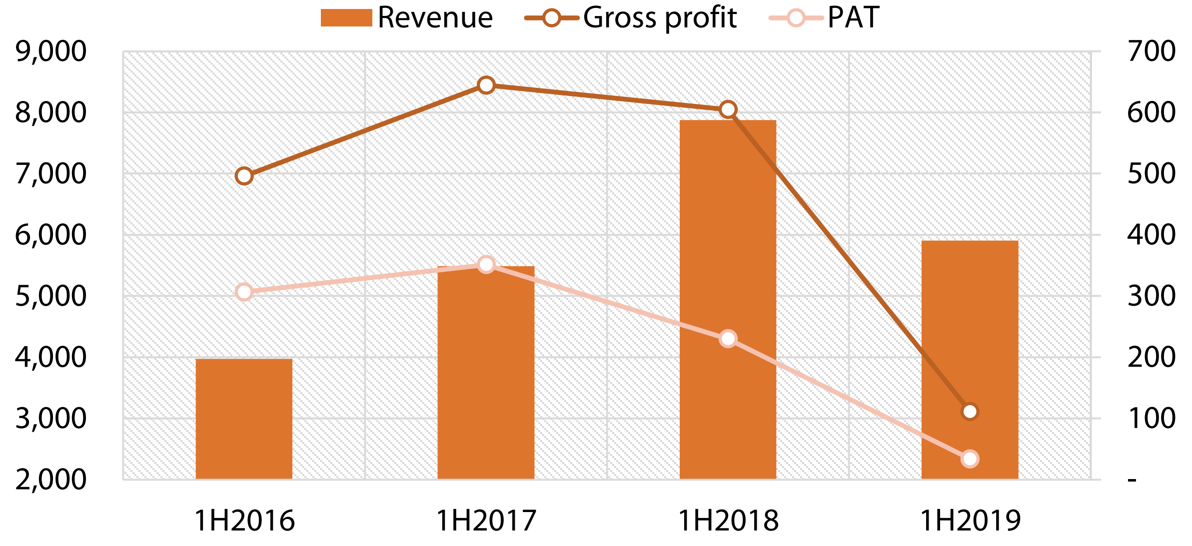
*(*) including one-off incomes.*

| **STOCK INFO** | |
|---|---|
| Sector | Materials |
| Market Cap ($ mn) | 49.7 |
| Current Shares O/S (mn shares) | 182.0 |
| 3M Avg. Volume (K) | 777.3 |
| 3M Avg. Trading Value (VND Bn) | 4.7 |
| Foreign Ownership (%) | 40.7 |
| State Ownership (%) | - |

| **FINANCIALS** | **2015A** | **2016A** | **2017A** | **2018A** |
|---|---|---|---|---|
| **Revenue** | 5,751 | 8,936 | 12,619 | 14,812 |
| *Growth (%)* | -1.5 | 55.4 | 41.2 | 17.4 |
| **NPATMI** | 126 | 518 | 708 | 57 |
| *Growth (%)* | 64.5 | 310.7 | 36.6 | -91.9 |
| ROA (%) | 3.9 | 10.4 | 8.5 | 0.6 |
| ROE (%) | 22.0 | 46.6 | 31.3 | 1.9 |
| EPS (VND) | 2.728 | 1.192 | 1.759 | 214 |
| Book Value (VND) | 3.515 | 8.667 | 16.156 | 16.325 |
| Cash dividend (VND) | 0 | 0 | 714 | 0 |
| P/E (x) | 2,6 | 3,0 | 2,1 | 52,9 |
| P/B (x) | 0,5 | 1,0 | 1,0 | 1,4 |

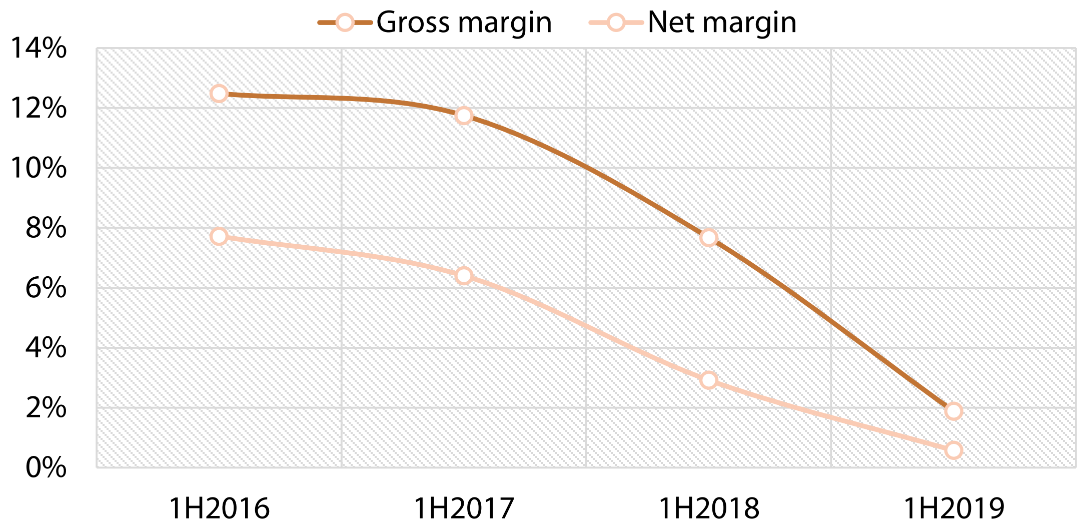
## NKG- Gross margin slashed by fluctuating HRC price

**Figure 1: 1H 2019 revenue (LHS) and gross profit & NPATMI (RHS) in VND bn**




*Source: NKG, Rong Viet Securities*

**Figure 2: Gross and net margins**




*Source: NK, Rong Viet Securities*

**The decreasing HRC price impacted strongly 1H2019 profit**

- Sale volume was 249,931 tons of coated steel sheets, -17.3% yoy; 82,789 tons of steel pipe, +4.5% yoy. Gross margin reduced to 1.9% because HRC price fluctuated strongly during the period.
- Gross profit was only VND 111 billion in 1H2019, but interest expense was VND 115 billion. It should be remarked that the interest expense in 1H2019 was 30% lowered yoy due to strong reduction in borrowings at the end of 2018. NKG would have made loss in 1H2019 without the one-off income.

**NKG's financial health is at critical conditions.**

- HRC went from ~USD 520 per ton to ~USD 480 during July and August, which is going to affect 2H's profitability.
- NKG is currently under pressure to reduce both short and long-term borrowings further because of its risky leverage. It means that the company might have to reduce its business size. In fact, NKG has just sold one of its plants (Nam Kim 1) and ownerships at several projects (Nam Kim Corea, Nam Kim 6).

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