RONG VIET SECURITIES

AUTOMOBILE INDUSTRY: Brighter But More Competitive

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AUTOMOBILE INDUSTRY - REVIEW

Automobile supply recovered substantially in 1H 2019

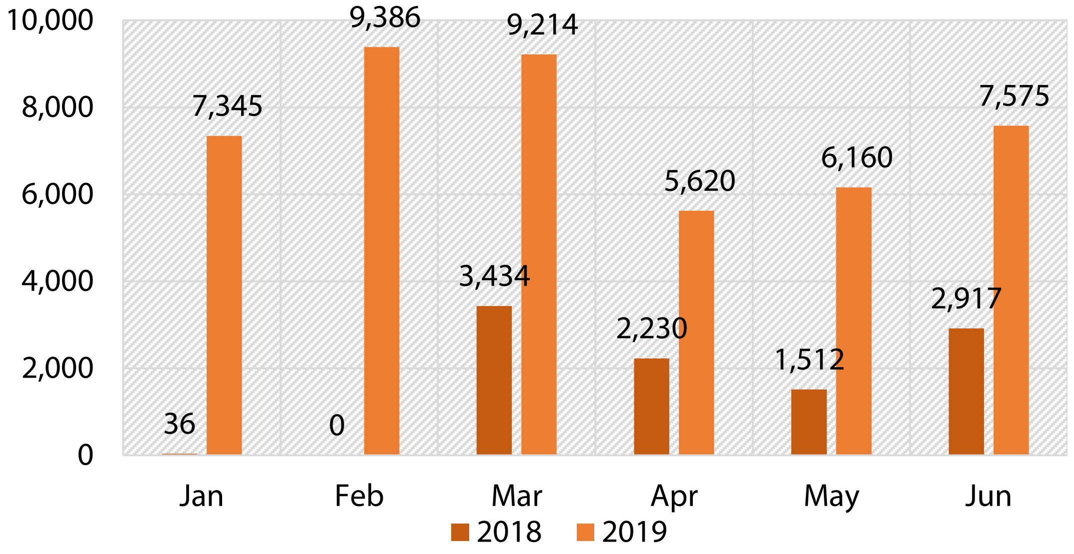
Auto supply in 2018 was weak

- In 8M 2018, the auto market faced difficulties in importing Completely Built-Up (CBU) cars due to the requirement of Vehicle Type Approval (VTA) certification under Decree 116, resulting in a fall of 13% YoY in 2018 CBU car supplies.

The auto industry witnessed an upsurge in car supply in 1H 2019

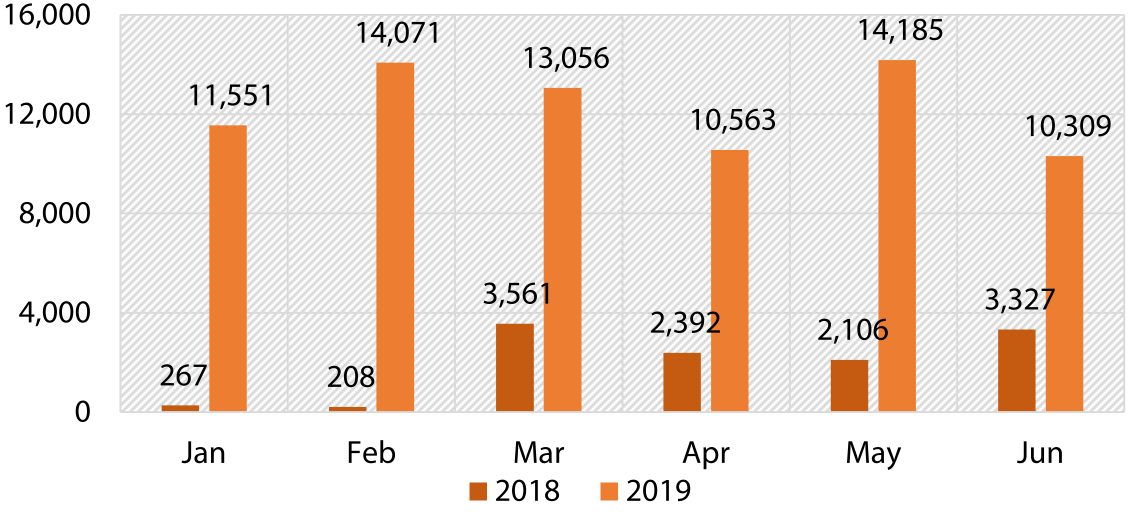
- Since late 2018, most producers that export cars to Vietnam met the requirements.
- Thanks to a removal of tariffs under ASEAN Trade in Goods Agreement (ATIGA), the number of cars imported from ASEAN nations, especially Indonesia and Thailand, witnessed a surge, intensifying the improvement in auto supply of total market in 1H 2019.

Figure 2: The number of imported cars from Thailand in 1H 2018-2019 *(unit)*



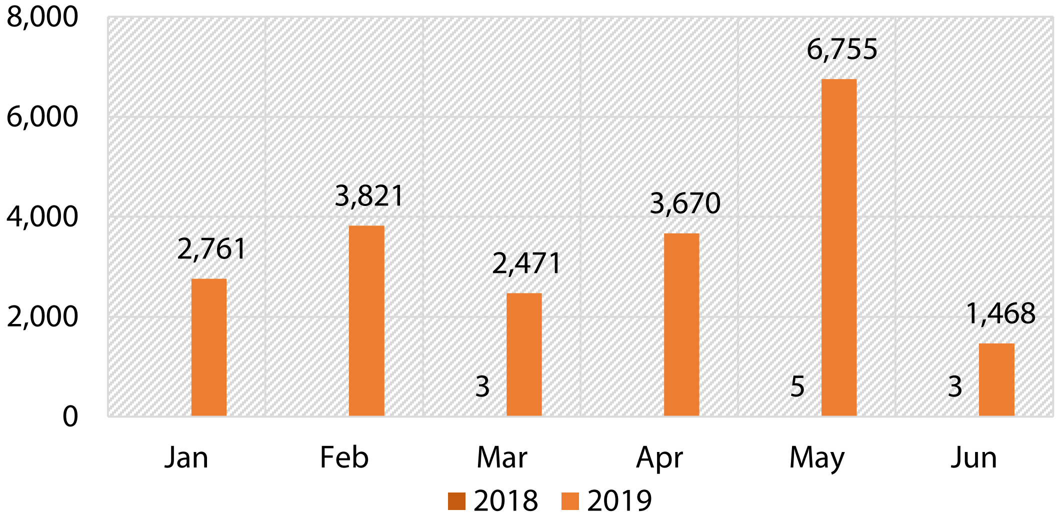
Source: Department of Customs, Rong Viet Securities

Figure 1: The number of imported cars in 1H 2018-2019



Source: Department of Customs, Rong Viet Securities

Figure 3: The number of imported cars from Indonesia in 1H 2018-2019 *(unit)*



Source: Department of Customs, Rong Viet Securities

AUTOMOBILE INDUSTRY - REVIEW

High demand and the decline in selling price boosted sales volume of auto market in 1H 2019

Demand for autos remains strong

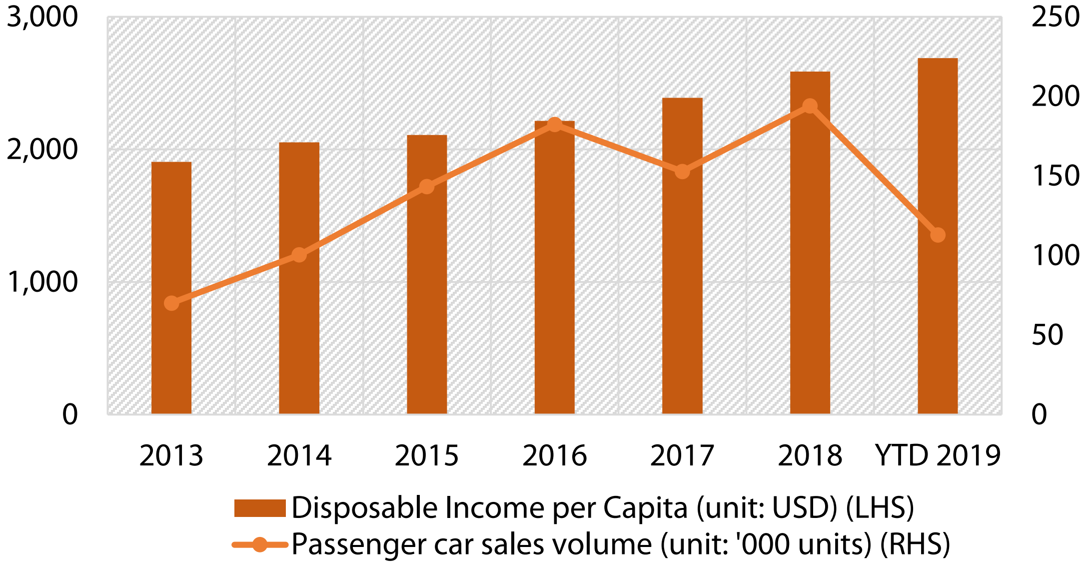
- 2018 weak car supply did not meet high demand, increasing the need of automobiles in 2019.
- Vietnam's disposable income per capita has improved quickly over the last five years and the trend may be ongoing from 2019 onwards.

Selling price of auto witnessed a strong decline in 1H 2019

- After the removal of tariffs under ATIGA, prices of autos coming from Indonesia and Thailand, ranging from VND 300 to 500 million, are suitable for income of most domestic residents. In addition, customers may have more choices due to a wide diversity of models from Indonesia and Thailand.
- The automotive outlook for the market in 1H 2019 was brighter but more competitive. Therefore, car dealers approached big promotions and decreased selling prices.

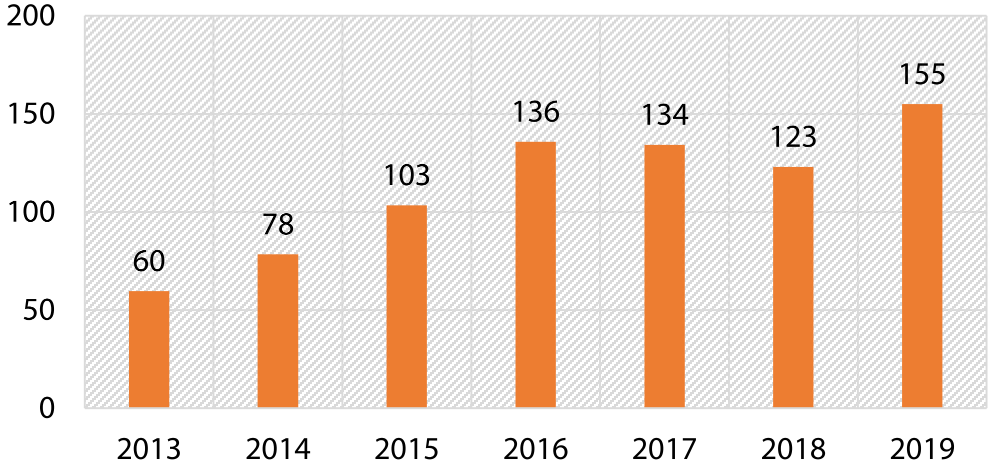
=> Sales volume of automotive market witnessed a surge of 21% to 154 thousand units in 1H 2019.

Figure 4: Disposable income growth



Source: VAMA, GSO, Rong Viet Securities

Figure 5: Total sales volume in the 1H of the 2013-2019 period *('000 units)*



Source: VAMA, Rong Viet Securities

AUTOMOBILE INDUSTRY - REVIEW

Stiff competition in the auto market has dragged gross profit margin (GPM) of car dealers down in 1H 2019

- In 1H 2019, revenue of most car dealers witnessed an increase thanks to high demand and supply in the auto market.
- However, high supply made competition in the market stiffer. Hence, many car dealers decreased selling prices in order to maintain market share and avoid high inventory levels, resulting in a fall in their GPM.

Turning to 2H 2019, we believe that competition remains fierce and even increase. However, we believe that middle-car dealers may face more intense competition than luxury car dealerships, as:

- o High-end car class targets affluent customers, who often prioritize their favorite brands over selling price.
- o Luxury auto customers have fewer choices than middle-class ones in terms of car dealerships and models.

Figure 6: Revenue from auto business of car dealers in 1H 2018-2019
(billion VND)

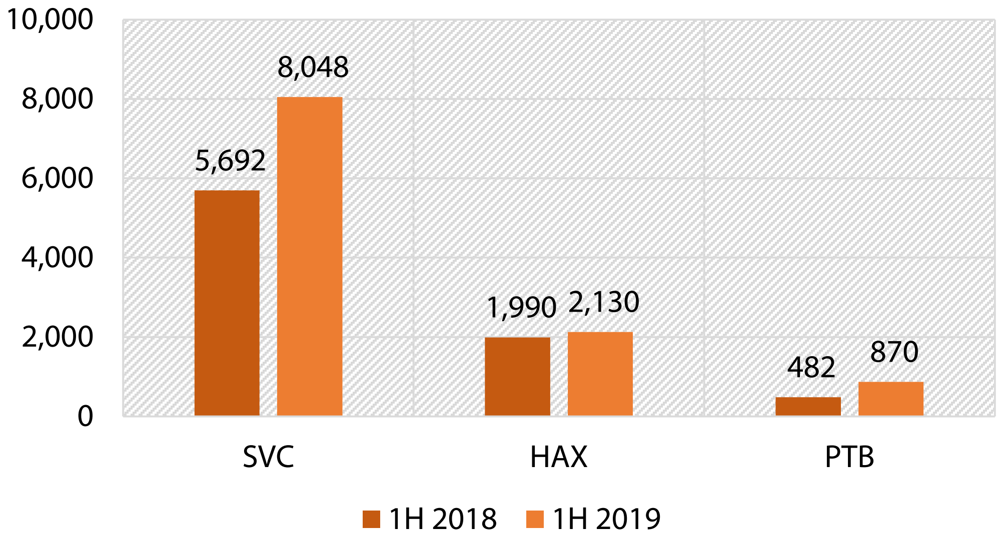
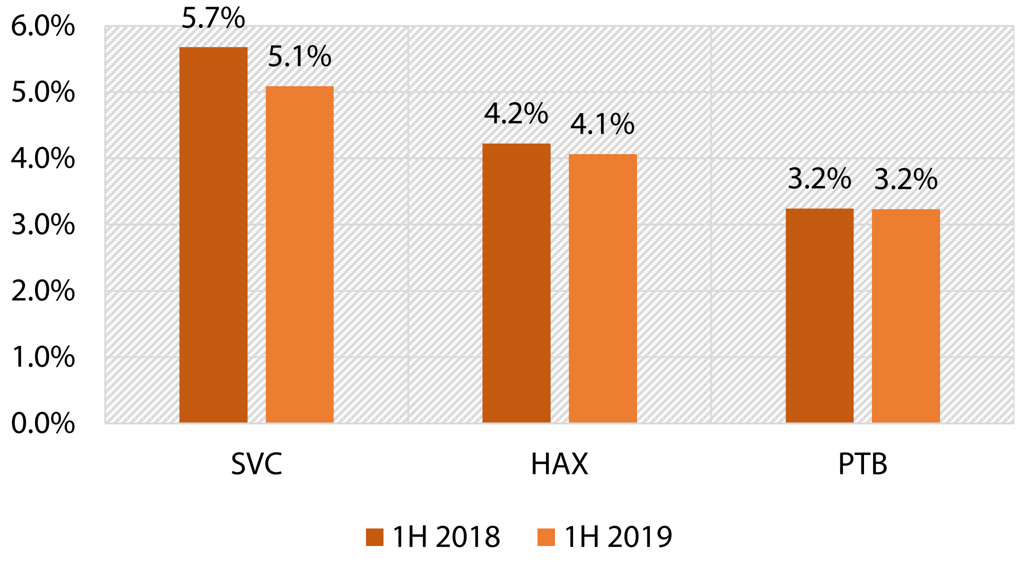


Figure 7: GPM of car business in 1H 2018-2019



Source: Rong Viet Securities

AUTOMOBILE INDUSTRY - REVIEW

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
HAX	18.5	15.3	2.2	1.3	2.1	1.9	7.5	3.5	5.7	23.4
SVC	31.1	105.8	2.0	1.6	98.0	1.1	1.2	8.2	4.6	18.3
HHS	-33.0	80.1	13.8	13.3	19.4	22.6	0.2	2.7	5.1	5.7
HTL	-1.0	-13.7	2.6	1.7	-29.2	2.2	0.3	3.5	4.0	9.0

HAX – Current valuation is relatively fair

INVESTMENT RATIONALES

- **Sales volume of HAX has benefited from strong position of MBV**
  - Since early 2019, Lexus and Audi import rebound, and BMW returned to auto industry. However, competitive advantages of MBV over its competitors such as sales policy and distribution system made competition pressure on MBV low. In 1H 2019, MBV still remains the leading player in the luxury automobile industry.
- **The recovery in auto supply and high demand are expected to boost 2019 sales volume of HAX.**
  - Car supply recovered in 1H 2019. In addition, demand in 2019 still remains strong as: (1) limited supply in 2018 has not met the high demand for luxury cars, (2) 'affluent' population is growing strongly. We estimate that sales volume of HAX in 2019 will reach around 2,700 units (+15% YoY).
- **Market share of HAX remained stable thanks to its competitive advantages**
  - Firstly, HAX owns showrooms at favorable locations. In addition, the firm has better human resource management policy than its competitors.
  - HAX got a significant expansion in market share to 38% from only 27% in 2017 and remained stable at 38% in 1H 2019.
- **Current valuation is relatively fair**
  - At current market price, HAX is trading at a P/E forward ratio of 7.0x, which we consider quite fair despite its business prospect.

RISKS TO OUR CALLS

- The unpredictable amount of incentives makes quarterly earnings of HAX highly volatile.
- The competition in the high-end auto market could be fiercer than expected, resulting in lower GPM than our forecast.

NEUTRAL +2%

CMP (VND)	**20,600**
Target price (VND)	**19,600**
Cash dividend in 12 months	*1,500*

STOCK INFO	
Sector	Automobiles & Parts
Market Cap ($ mn)	33
Current Shares O/S (mn shares)	37
3M Avg. Volume (K)	121
3M Avg. Trading Value (VND Bn)	2.0
Foreign Ownership (%)	9.1
State Ownership (%)	0.0

FORECAST	2017A	2018A	2019F	2020F
Revenue	3,833	4,756	5,328	5,877
Growth (%)	33.1	24.1	12.0	10.3
NPAT	84	99	108	120
Growth (%)	8.1	17.0	9.6	11.4
ROA (%)	5.7	5.4	6.1	6.8
ROE (%)	21.8	21.9	21.4	21.0
EPS (VND)	3,611	2,815	2,952	3,289
Book Value (VND)	11,017	12,832	13,790	15,644
Cash dividend (VND)	-	1,500	1,500	1,500
P/E (x)	9.7	7.3	7.0	6.3
P/B (x)	1.4	1.6	1.5	1.3

HAX – Gross profit margin (GPM) has declined slightly due to high competition

Revenue and earnings saw a divergence in 1H 2019

- Thanks to high demand and supply, sales volume of HAX witnessed an increase of 10%YoY to 1,150 units in 1H 2019, resulting tin a 10% improvement in revenue.
- A strong increase in car supply intensified the competition in the market, leading to a slight decline in 1H 2019 gross profit margin of HAX's automobile business from the high base of 1H 2018.

This situation will still happen in 2H 2019

- For 2H 2019, despite an improvement in sales volume, we believe that the competition remain high, dragging GPM of the company in 2H 2019 from the high base of 2H 2018.

Figure 1: Sales volume of HAX in 1H in the 2018-2019 period *(cars)*

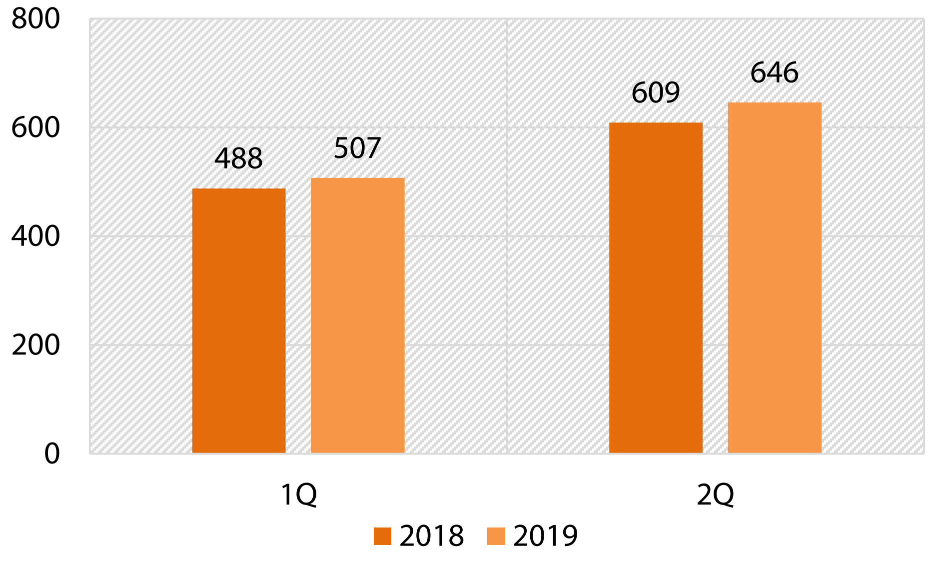
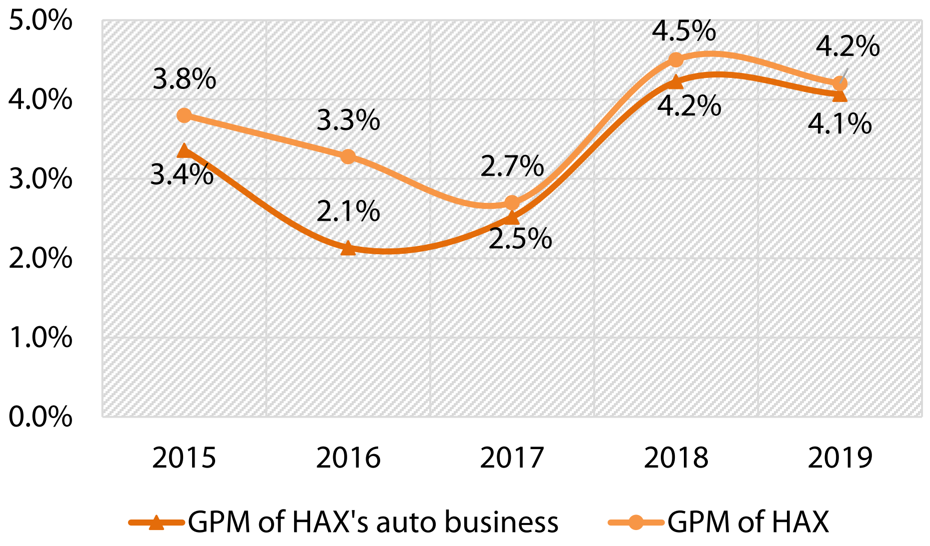


Figure 2: GPM of HAX's car business and the company in 1H of 2015-2019



Source: HAX, Rong Viet Securities

DRC – Expansion in export market boosts sales volume

INVESTMENT RATIONALES

- **Sales volume of radial tires is supported by expansion of export markets**
  - Sales volume from current export markets is stable. DRC is supplying 20 thousand tires/months to Brazilian market and 7-10 thousand tires/month to Asian market.
  - Since 2Q 2019, DRC started to export to US market with volume of 8-10 thousand tires/ month, contributing to 20% of 2019 forecasted sales volume of radial tires.
- **The decrease in sales volume of bias ties is expected to be slight**
  - Competition in bias tire market is low.
  - The shift from bias tires to radial ones is moderate in the short and middle term.
- **DRC's prospect from 2021 onward to enhance significantly**
  - By 2020, equipment of phase 1 of radial factory will be fully depreciated. Hence, from 2021onward, in our estimation, depreciation expense would decline VND 150 billion per year, resulting in a 30% CAGR of earnings in 2018 – 2021 period.
  - The company has some loans coming due in 2019 - 2020, resulting in lower debt repayment pressure from 2021 onwards. Hence, we believe that FCFE from 2021 will expand significantly, enabling the company to pay high cash dividend to shareholders.

RISK TO OUR CALLS

- Uncertainty remains over whether Brazil's anti-dumping duties on Chinese tires, overdue at the end of 2019, will be extended. DRC may face fierce competition from Chinese tires.

ACCUMULATE +13%

CMP (VND)	**21,600**
Target price (VND)	**23,600**
Cash dividend in 12 months	*1,000*

STOCK INFO	
Sector	Automobile & Parts
Market Cap ($ mn)	110
Current Shares O/S (mn shares)	119
3M Avg. Volume (K)	293
3M Avg. Trading Value (VND Bn)	6.0
Foreign Ownership (%)	23.3
State Ownership (%)	50.5

FORECAST	2017A	2018A	2019F	2020F
Revenue	**3,669**	**3,551**	**3,875**	**4,101**
Growth (%)	9.2	-3.2	9.1	5.8
NPAT	**166**	**139**	**155**	**181**
Growth (%)	-58.0	-16.5	11.9	16.7
ROA (%)	5.9	4.9	5.5	7.0
ROE (%)	10.9	9.1	10.1	11.5
EPS (VND)	1,286	1,085	1,214	1,416
Book Value (VND)	12,853	12,819	12,938	13,193
Cash dividend (VND)	1,300	900	1,000	1,000
P/E (x)	18.8	19.8	17.0	14.5
P/B (x)	1.9	1.7	1.6	1.6

DRC – The increase in selling price and expansion in export market boosted sales volume

Figure 1: Sales Volume of Radial and Bias tires (thousand tires)

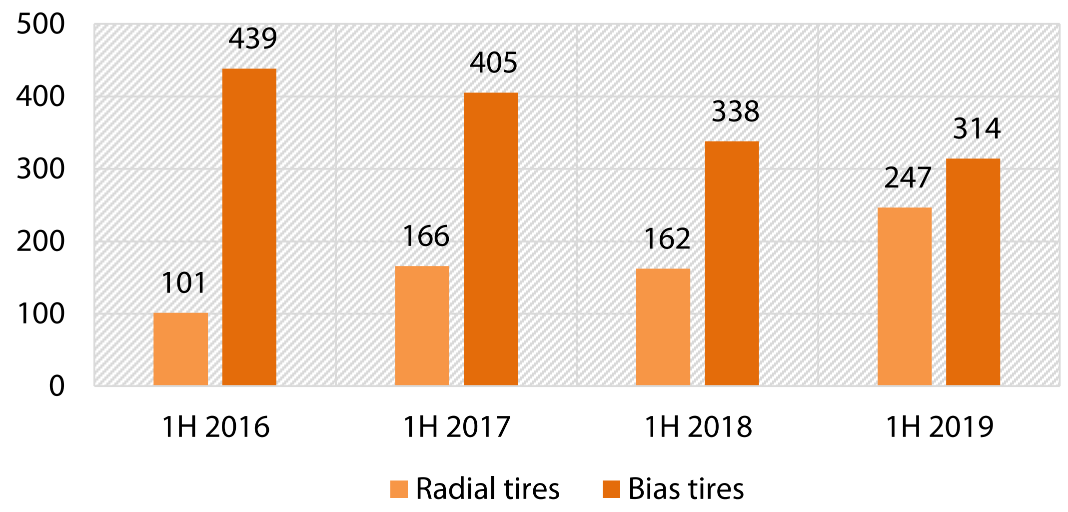
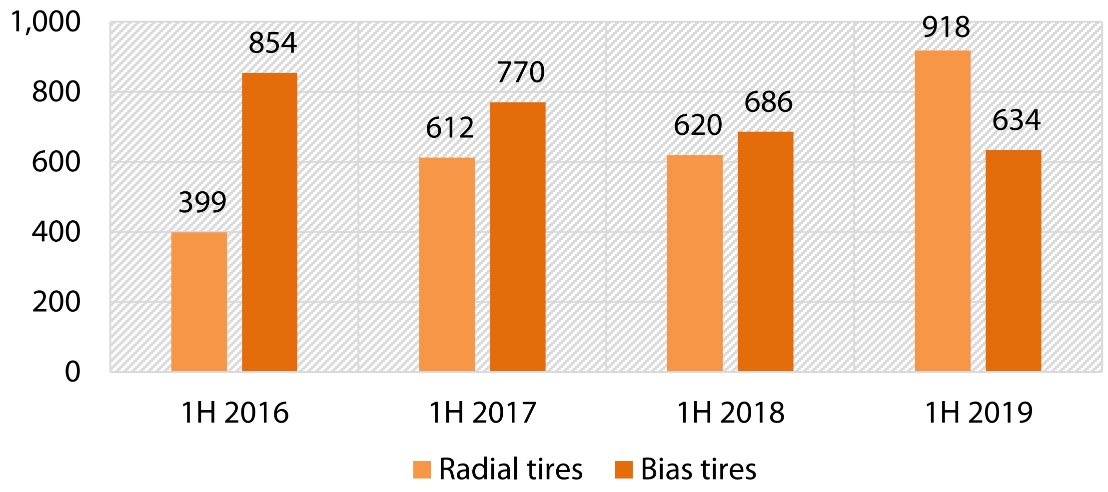


Figure 2 : Revenue of Radial and Bias tires (VND bn)



Source: DRC, Rong Viet Securities

In 1H 2019, DRC reported revenue of VND 1,920 bn (+16% YoY); NPAT of VND 139 bn (+17% YoY)

- Selling volume of radial tires saw a strong improvement of 52% YoY to 246 thousand tires as:
  - Capacity of radial factory doubled to 600 thousand tires/year since July 2018
  - The 5% increase in selling price in April 2019 made distributors accumulate a large number of tires
  - Since March 2019, DRC started to export to US market with volume of 8-10 thousand tires/ month, contributing to 16% of 1H sales volume of radial tires
- Sales volume of bias tires reached 314 thousand tires (-7% YoY) due to the trend of shift to radial tires. However, as a 5% increase in selling price of bias tires in March 2019 made distributors accumulate a large number of tires, the decline in 1H sales volume was slight.

We expect relative stability in 2H 2019 performance

- Compared to 1H 2019, sales volume of 2H 2019 is forecasted to decrease slightly as distributors accumulated a large number of tires in 1H 2019.
- Exports in 2H 2019 is expected to remain stable.

Despite stiff competition in domestic market, we still expect a growth in 2019 performance thanks to expansion in export markets and increase in selling price

- We forecast 2019 revenue and NPAT will reach 3,875 billion (+9%) and 155 billion (+12% YoY).

Table 1: Forecasted sales volume of DRC's core products *(in thousand units)*

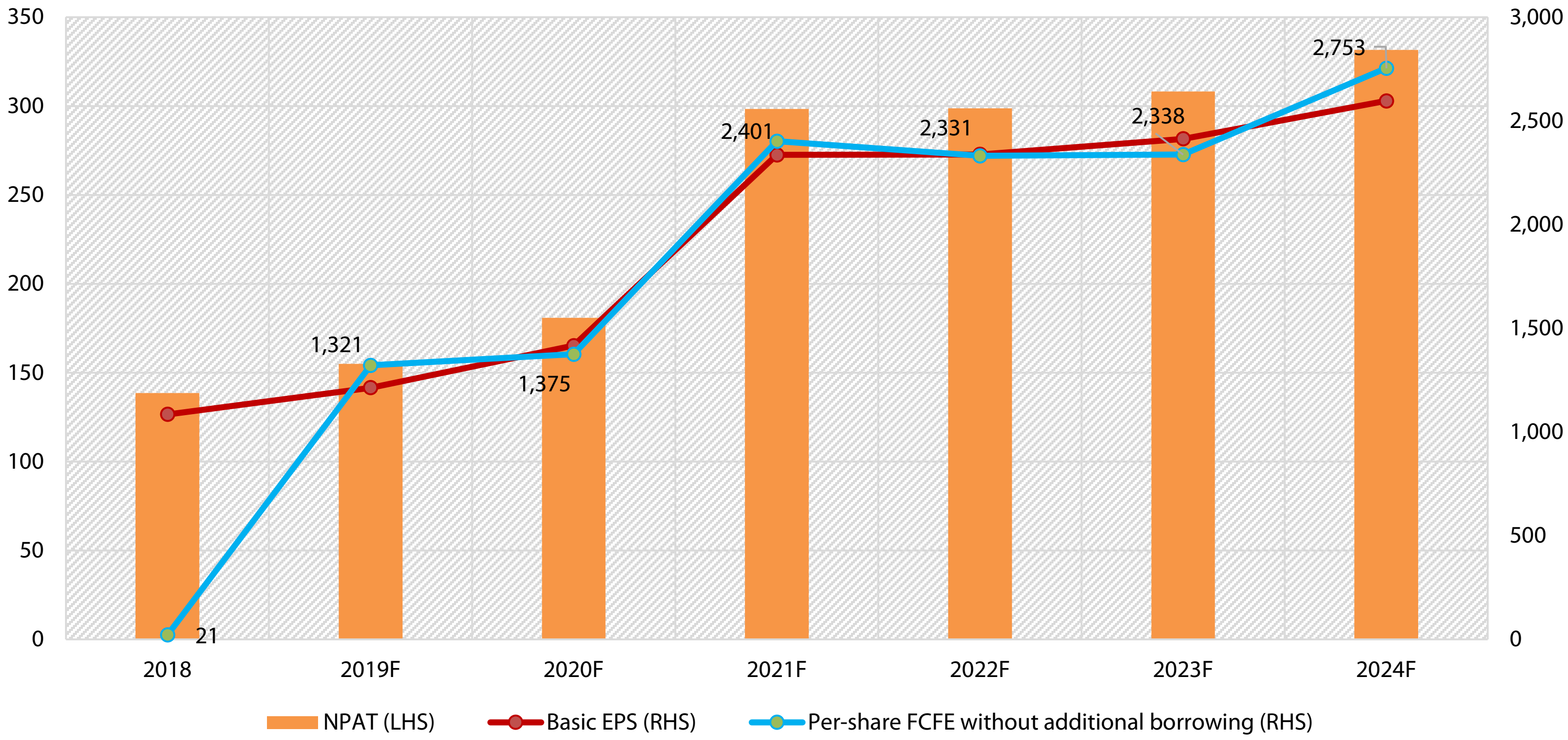
Types	2017	2018	2019F	Change YoY	Note
Heavy truck bias tires	168	162	154	-5%	• A moderate short-term shift from bias tires to radial ones • Low competition in bias tire market • Their ability to tackle rough roads in rural areas in Vietnam
Heavy truck radial tires	333	376	469	25%	• Export: 70%, Domestic market: 30%
Light truck bias tires	664	493	458	-7%	• 12% lower prices compared to LTRs => Slight switch to LTRs
Light truck radial tires (LTRs)		0.7	1.1		• No OEM deal is expected to sign

Source: Rong Viet Securities forecasts

DRC – Positive outlook from 2021 onwards

- **Impressive growth in 2021 earnings**
  - o By 2020, depreciation expense would decline VND 150 billion/year resulting in a 30% CAGR of earnings in 2018 – 2021 period.
- **Free cash flow from 2021 would be high**
  - o DRC has some loans coming due in 2019 - 2020, resulting in lower debt repayment pressure from 2021 onward. Hence, we believe that FCFE from 2021 will expand significantly, enabling the company to pay high cash dividend to shareholders.

Figure 3: DRC's per-share FCFE and per-share earnings



Source: DRC, Rong Viet Securities forecasts

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