SPARE PARTS

FACING OBSTACLES IN THE SHORT-TERM

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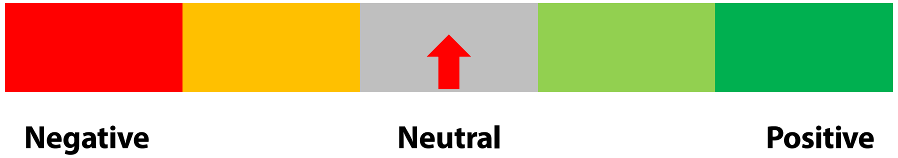
SPARE PARTS – FACING OBSTACLES IN THE SHORT-TERM

Investment Rating



Overview

We expect the industry will show positive sales growth in the 2H2023 after experiencing the negative growth in 1H2023. The main reason is the increase of logistic activities. On the one hand, due to price competitive pressure from China tyres, we, however, suppose that Vietnam spare part producers might lower the selling prices to boost sales. On the other hand, the significant reduction of raw material prices and ease of logistic costs could partly compensate the decrease in the output prices in 2H2023. Therefore, profit might improve in 2H2023 though expected to record a negative growth YoY.

Highlights

Profit decreased at a higher rate than the revenue due to decline in selling prices

- In 1H2023, total sales of spare parts decrease, driven by the weak demand of local market. Furthermore, the increasing price competitive from China producers led Vietnam producers to lower the selling prices. This action threats the profit of Vietnam spare part producers.
- Q2 2023 sales of Vietnam spare parts companies was higher than Q1 2023 and flat compared to Q2 2022. However, the decrease in output prices partly grabbed the profit generated from lower raw material costs which were put into production since Q2 2023. As a result, the net profit of the spare parts producers showed continuous negative growth in the first two quarters of 2023.

The growth engine for sales will become more favorable in 2H2023

- On the expected improvement of export-import activities, travelling purposes and logistic demands, we suppose that the number of vehicles in circulation and miles driven in Vietnam will be higher in 2H2023. The result is the consumption of spare parts, especially tyres, will grow, supporting the local sales growth.
- Based on the historical exported sales, we suppose that the export demand is intact to economic cycle. After Covid-19 pandemic, we predict that the global travelling purpose will be denser following the economic recovery, encouraging consumption of both OEMs and replacement spare parts, especially the U.S. market. Notably, Vietnam is one of the top 10 companies export tyres to the U.S., thus we expect that 2H2023 export sales will be more positive.

SPARE PARTS – FACING OBSTACLES IN THE SHORT-TERM

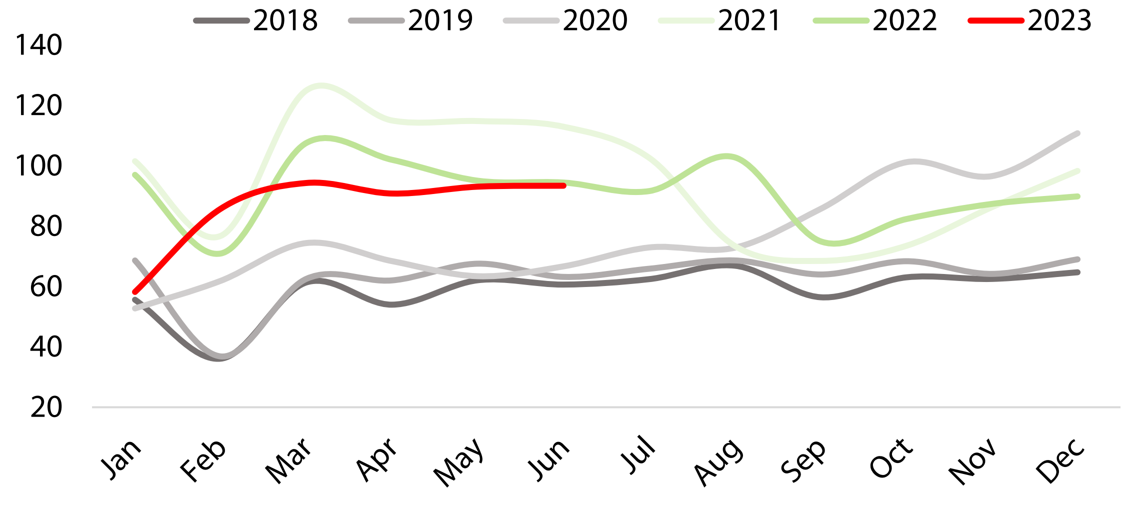
Highlights	**Decreasing input prices and logistic costs would partly compensate the reduction in selling prices** • We suppose that 2H2023 profit of the industry will be better than 1H2023, though being lower than the same period last year in the context of price war. The main supporters are 1) the decrease in the prices of natural rubbers, synthetic rubbers, and coals; and 2) the ease of logistic costs. • In 2022, the disruption of the global supply chain led the logistic cost rocketed. These costs have decreased since the beginning of 2023 and being traded at the below-year ago level at current.
Valuation	The valuation of Vietnam **spare parts stocks** became lower compared to the beginning of 2023 under the weak performance of the industry. Based on the expectation that 2H2023 results would improve compared to 1H2023, we suppose that the valuation would not decrease further.
Stocks Recommendation	**DRC** (NEUTRAL, TP: VND 21,500)
Risks	• **Tax decisions from foreign markets.** The export markets such as the U.S. could apply tax decision on imported spare parts from Vietnam, resulting in lower demand on exported markets. • **China customers – the largest consumer of rubbers – could be back to increase their rubber demand, leading to the upward trend of rubber prices, giving pressure on production costs of the industry.** In 1H2023, the prices of rubbers decreased because of the lower demand from China despite of the lower supply due to El Nino season.

PROFIT DECREASED AT A HIGHER RATE THAN THE REVENUE

Declining in selling prices threaten profit.

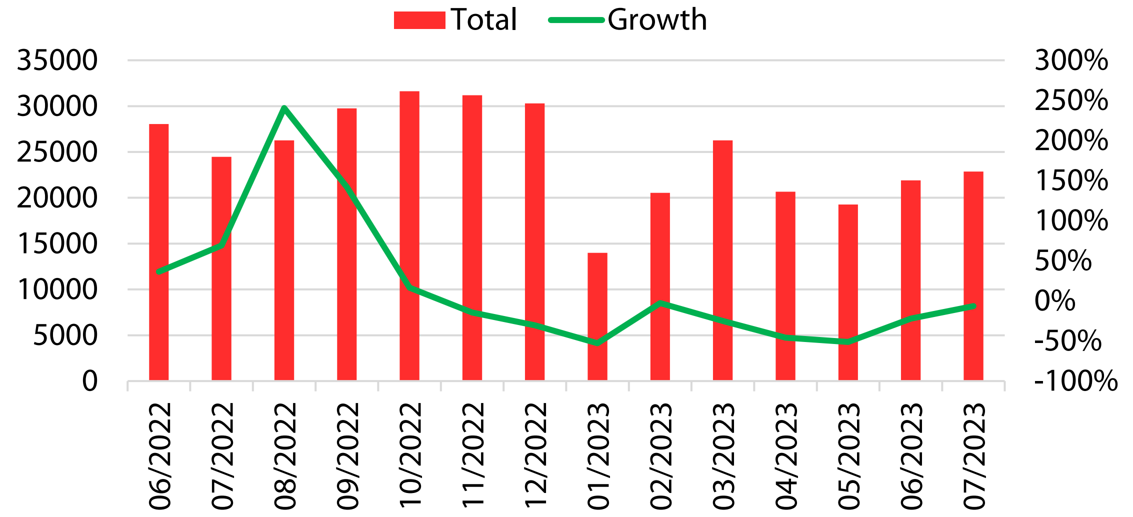
- In 1H2023, total sales of spare parts reduced, driven by weak demand of domestic market. For example, the export value of rubber products (mainly tyres) present a negative growth of -9.1% YoY. The selling volume of total vehicles was 122,626 units (-36% YoY) in 1H2023. We suppose that the weak demand of total vehicles sales is a negative indicator for the sales of spare parts. Besides, the increasing price competitive from China producers led Vietnam producers to lower the selling prices.
- However, the positive sign is that Q2 2023 sales of Vietnam spare parts companies was higher than Q1 2023 and flat compared to Q2 2022. In addition, 1H2023 export value though was lower than the period of 2021-2022 (Covid-19 pandemic), it remains being higher than the pre Covid-19 pandemic. We suppose that Q1 2023 sales was the bottom of these companies. However, the decrease in output prices partly grabbed the profit generated from lower raw material costs which were put into production since Q2 2023. As a result, the net profit of the spare parts producers showed continuous negative growth in the first two quarters of 2023.

Figure 1: Export value of rubber products (included tyres) (USD mn)



*Source: Fiinpro, RongViet Securities. *Greenlines are the Covid-19 pandemic period.*

Figure 2: Total sales of Vietnam vehicles (units, LHS) and growth (% YoY)

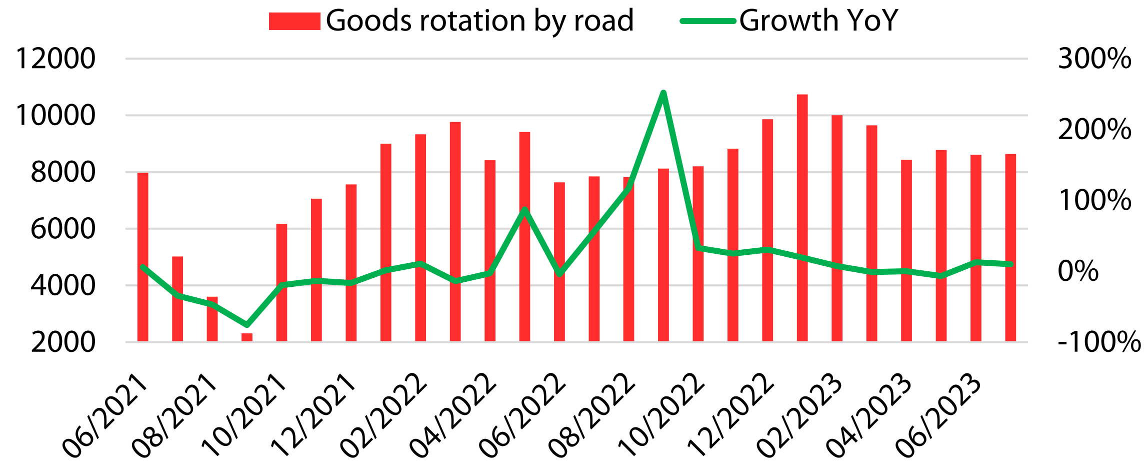


Source: VAMA, RongViet Securities.

The growth engine for sales will become more favorable in 2H2023

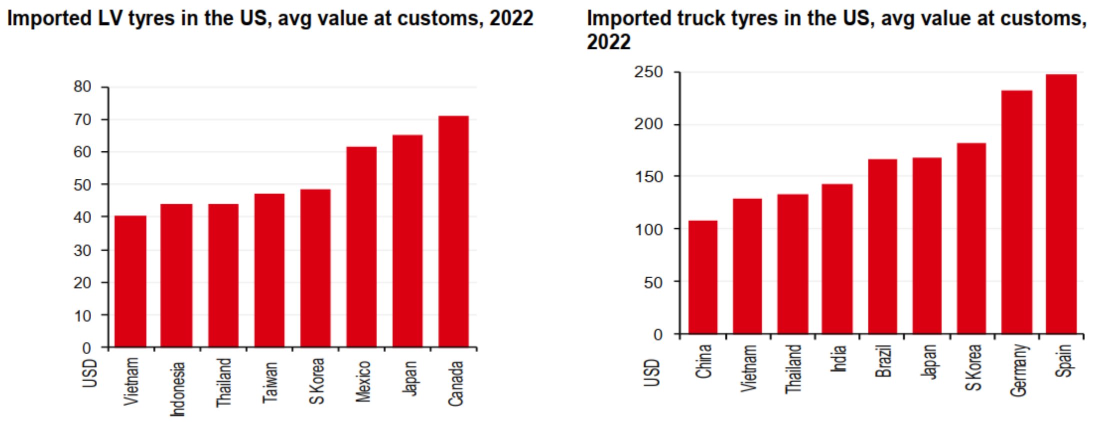
- We expect that 2H2023 export-import activities will be higher than 1H2023 as global economy is recovering. Notably, Chinese government issued various policies to support for the economy with a focus on expanding domestic demand. Therefore, we expect that the export to China markets will increase. In addition, the upcoming holiday seasons as well as the recovering of tourism activities is expected to warm-up the travelling purposes. Besides, the logistic demands is also expected to be higher in 2H2023 under the recovering of the economy. All in all, these positive factors will drive the number of vehicles in circulation and miles driven in Vietnam to be higher in 2H2023. The result is the consumption of spare parts, especially tyres will grow, supporting the local sales growth.
- Based on the historical exported sales, we suppose that the export demand is intact to economic cycle, evidenced by the upward trend in the last five years. After Covid-19 pandemic, we predict that the global travelling purpose will be denser following the economic recovery, encouraging consumption of both OEMs and replacement spare parts, especially the U.S. market – the leading economy. Notably, Vietnam is one of the top 10 countries exporting tyres to the U.S., thus we expect that 2H2023 export sales will be more positive.

Figure 3: Vietnam good rotations by road (mn tons.km, LHS) and growth (% YoY, RHS)



Source: GSO, RongViet Securities.

Figure 4: Vietnam is one of the top 10 countries exporting tyres to the U.S. in 2022

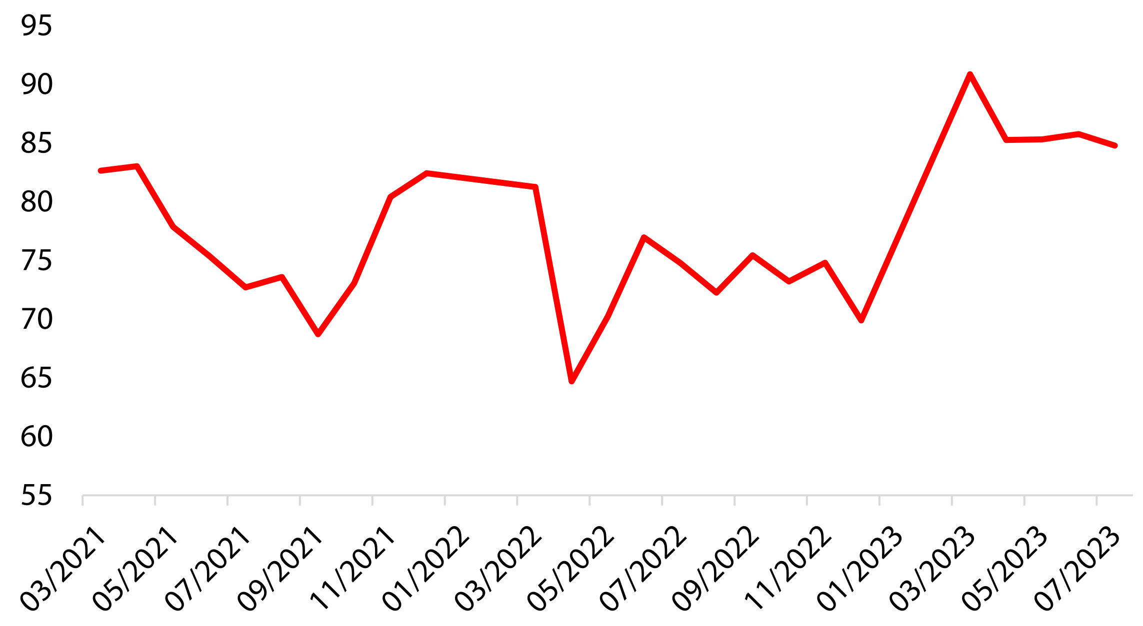


Source: HSBC, RongViet Securities.

Decreasing input prices and logistic costs would partly compensate the reduction in selling prices

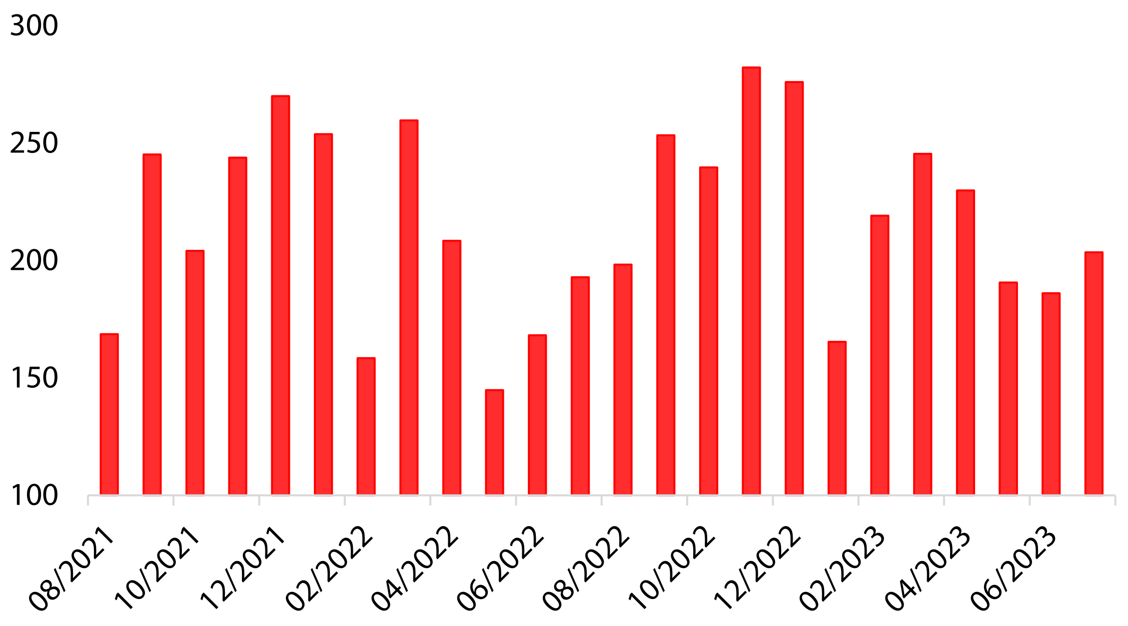
- We suppose that 2H2023 profit of the industry will be better than 1H2023, though being lower than the same period last year in the context of price war. The main supporters are 1) the decrease in the prices of natural rubbers, synthetic rubbers, and coals; and 2) the ease of logistic costs.
- In 1H2023, China 's total export volume of tyre was 347 mn tons (+18.4% YoY). We expect that Chinese tyre makers will continue to push their export in 2H2023 as they has resumed their production activities after the lockdown period. In fact, Chinese tyre producers has raised their demand for tyres 'raw materials such as natural rubbers or coal in July 2023, signaling a higher tyre supply in 2H2023. As a result, we suppose that Vietnamese tyre makers would have to continue to reduce their selling prices to protect sales.

Figure 5: Tyre export of China (mn tons)



Source: Bloomberg, RongViet Securities.

Figure 6: Volume of natural rubber imported from China ('000 tons)

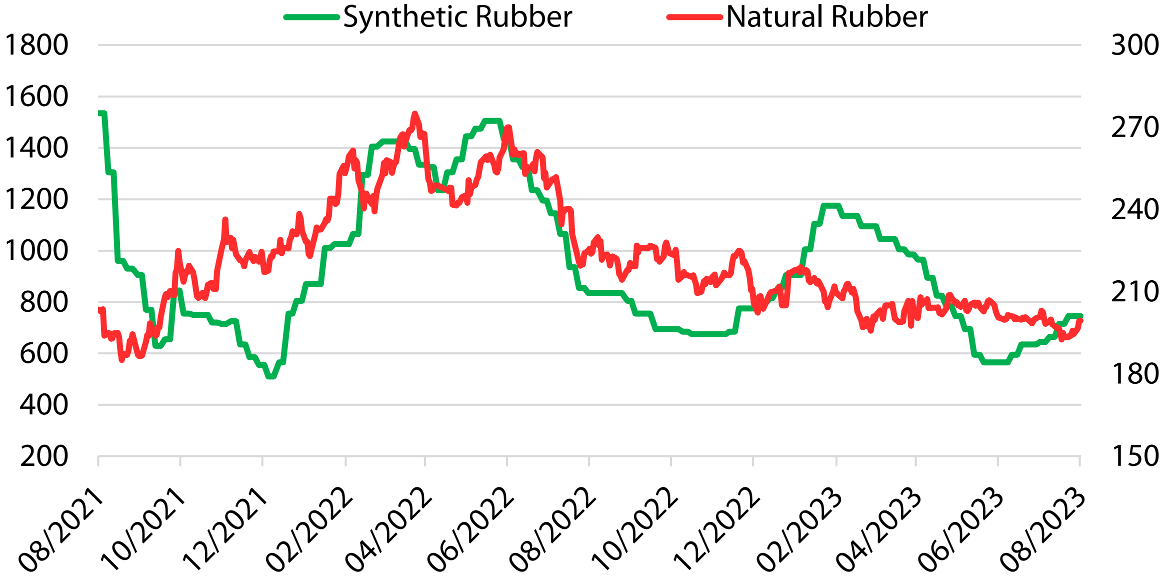


Source: Bloomberg, RongViet Securities.

Decreasing input prices and logistic costs would partly compensate the reduction in selling prices

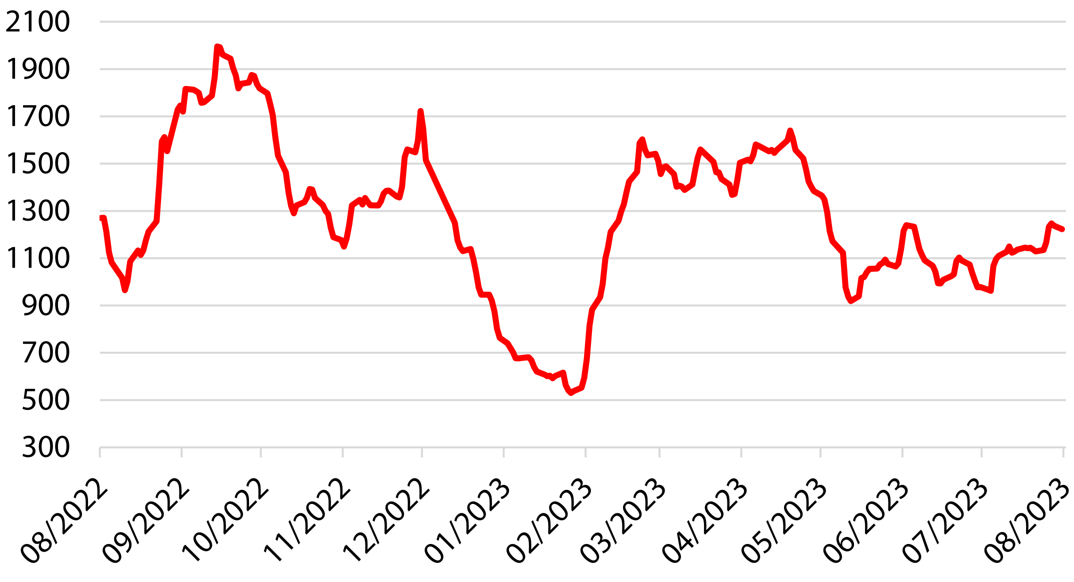
- Since the beginning of 2023, the prices of natural rubbers, synthetic rubbers and coals has drop until present. As of Jul 27th 2023, the prices of these three commodities were JPY/kg 200 (-20% YoY), USD/MT 725 (-42% YoY), and USD/MT 134 (-68% YoY), respectively. We expect that these raw material would be traded at the below-year ago level in 2H2023, partly compensate for the lower output selling prices.
- In 2022, the disruption of the global supply chain led the logistic cost rocketed. These costs have decreased since the beginning of 2023 and being traded at the below-year ago level at current. As of Jul 27th 2023, the BDI reached 1,097 points (-45% YoY). We expect that the ease of logistic cost will be another arm of Vietnam spare parts producers to lessen the negative impact of lower output prices.

Figure 7: The prices of natural rubbers (JPY/kg, RHS) and synthetic rubbers (USD/MT, LHS)



Source: Bloomberg, RongViet Securities.

Figure 8: Baltic Dry Index (pts)



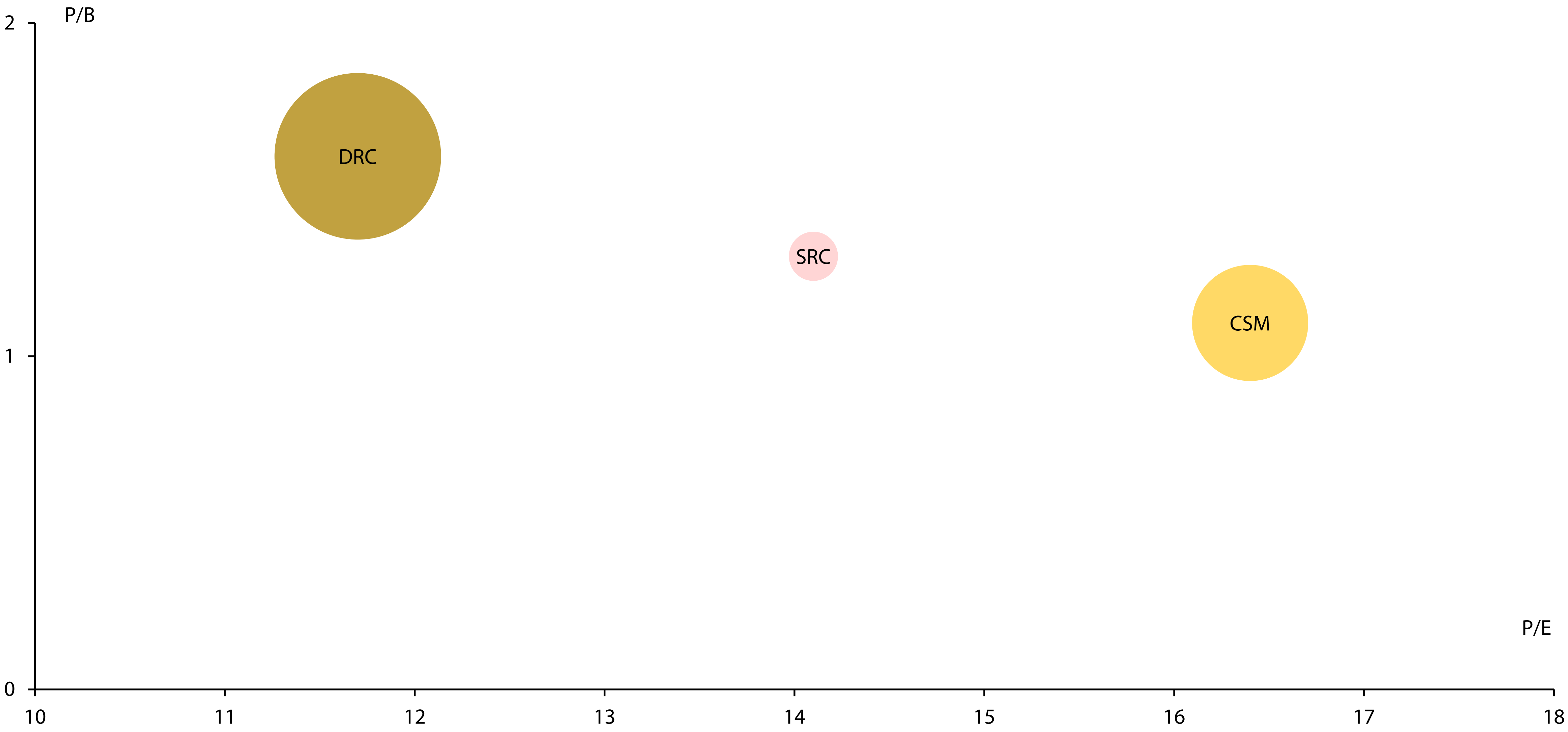
Source: Bloomberg, RongViet Securities.

INDUSTRY COMPARABLE (TTM)

Ticker	Mkt Cap. ($mn)	Target price (VND)	Closing price (07/31/2022)	NTM Cash dividend	Foreign room leftover %	Revenue growth %YoY			NPAT-MI growth %YoY			2023 's Profitability		P/E		P/B	
						2022A	2023F	2024F	2022A	2023F	2024F	ROA(*)	ROE(*)	Cur.(*)	5 Yr. AVG	Cur.(*)	5 Yr. AVG
DRC	116	21,800	21,500	1,400	38.7	11.9	0.7	1.8	5.0	-10.2	15.9	8.6	13.8	9.9	12.2	1.4	1.7
CSM	61	N.R	13,900	n.a	49.3	9.9	n.a	n.a	27.6	n.a	n.a	5.6	1.7	16.4	56.5	1.1	1.3
SRC	23	N.R	n.a	n.a	48.9	-4.2	n.a	n.a	-34.6	n.a	n.a	1.2	0.4	14.0	17.0	1.3	1.3

Source: Fiinpro, RongViet Securities. Share price as of 31 Jul 2023.

PE, PB AND ROE (TTM)

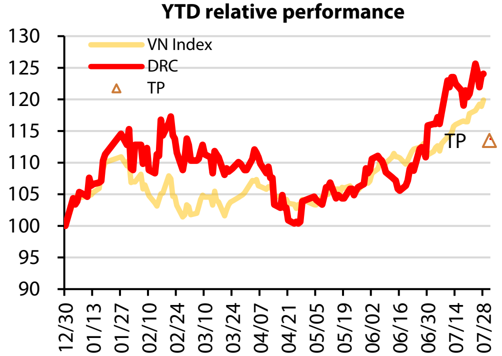


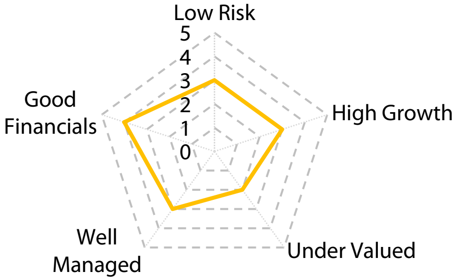
Source: Fiinpro, RongViet Securities. Bubble size equals respective ROE. Share price as of 31 Jul 2023.

RAW MATERIAL COSTS REDUCTION IS THE KEY

HSX: DRC

NEUTRAL: -1% **MP: 23,100** **TP: 21,500**





STOCK INFO

Sector	Spare parts
Market Cap ($ mn)	116
Current Shares O/S (mn shares)	119
3M Avg. Volume (K)	560
3M Avg. Trading Value (VND Bn)	12
Remaining foreign room (%)	39
52-week range ('000 VND)	16,1 – 32,0

FINANCIALS

FINANCIALS	2022A	2023F	2024F
Revenue (VND bn)	4,899	4,959	5,039
NPATMI (VND bn)	308	200	236
ROA (%)	16.7%	10.4%	11.9%
ROE (%)	16.6%	8.2%	9.6%
EPS (VND)	2,438	1,581	1,866
Book Value (VND)	16,082	16,430	17,035
Cash dividend (VND)	1,500	1,400	1,200
P/E (x)	7.9	13.5	11.5
P/B (x)	1.3	1.3	1.2

INVESTMENT RATIONALES

Negative profit growth due to China 's headwinds

- Consolidated 1H2023 sales went down by -6.5% YoY, driven by both of lower average selling prices and lower total selling volumes. Equipped by high-price inventory, 1H2023 net profit drop by -49% YoY. The import tax on truck tyres from Brazil market, fierce competition from China, and weak tyre demand in local market destroyed DRC 's 1H2023 performance.
- We predict that Chinese producers will continue to lower their selling prices in 2H2023 and onwards, pressuring Vietnamese tyre producers to reduce their selling prices further.

Growth in selling volume to offset unfavorable selling prices since 2H2023

- In Q2 2023, total selling volume presented a QoQ growth, of which, the export and domestic volumes increased by +2.6% QoQ and +25% QoQ, respectively. Particularly, regarding to export markets, we expect that higher export orders from other markets such as the U.S. or Malaysia will compensate lower export orders from Brazil market, resulting in an expected flat exported volumes in the future. In the expectation that the number of vehicles in circulation and miles driven in Vietnam to be higher since 2H2023, we believe that DRC's domestic selling volume will show an upward trend since 2H2023.

Decreasing input costs to encourage double-digit growth since 2024

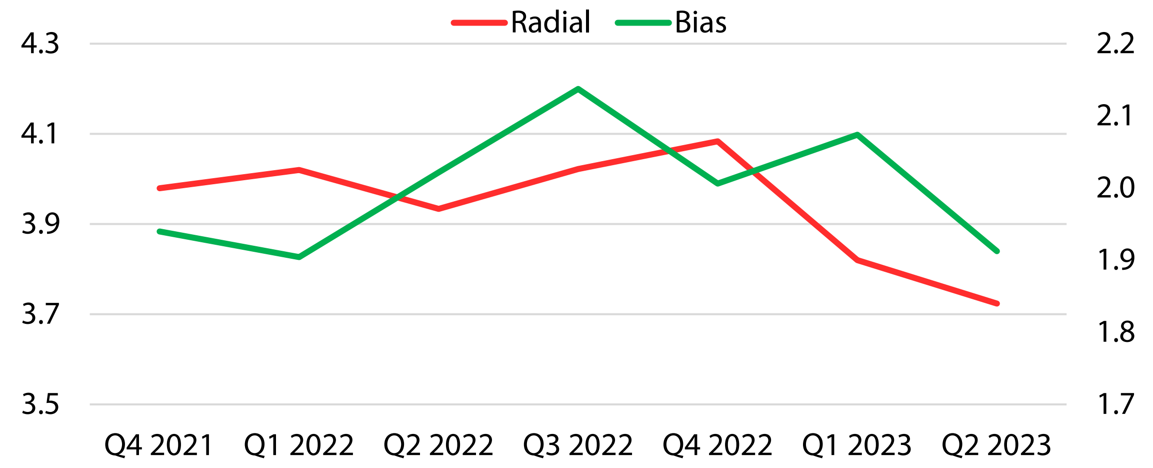
- We expect that the lower-price rubbers and coal materials to be used since Q3 2023, partly offsetting the selling price reduction in 2H2023. In Q2 2023, DRC has put lower-price rubbers into production, per company data. The bottom line in 2023, however, will still show negative YoY growth due to low selling prices and high input costs effect of 1H2023.
- We predict that the domestic sales will recover since 2H2023 and continue to go up in 2024 after experienced a downward trend since 2019 period. The higher domestic sales contribution, together with below-year ago level input costs will encourage DRC's net profit to grow by double digit in 2024 period.

A suitable investment under the "dividend investing strategy" with annual average dividend yield of over 5%

RISKS TO OUR CALL

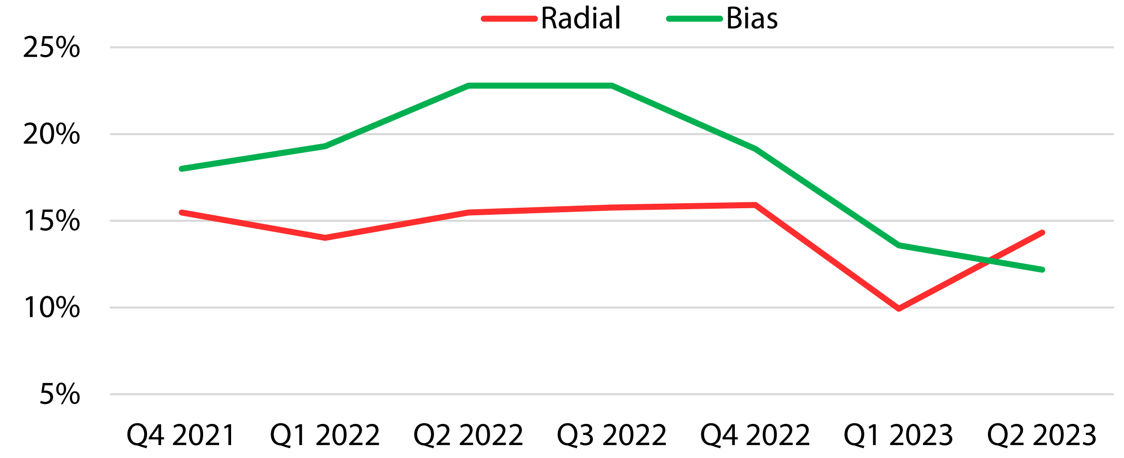
- The raw material costs would be back to the upward trend because of unexpected global factors such as bad weather or abnormal strong demand from China.

Figure 1: Selling price has decreased since Q4 2022 due to fierce competition from China (VND mn/ tyre) – Radial (LHS) and Bias (RHS)



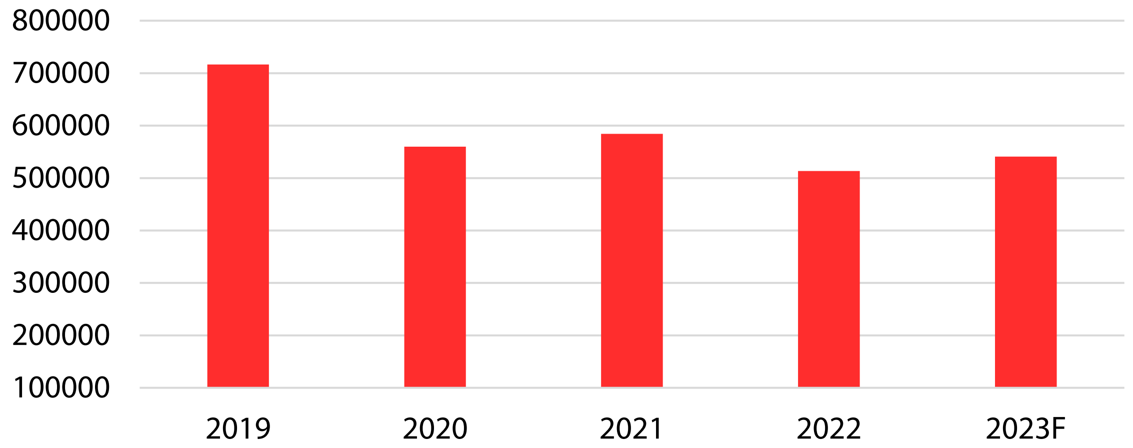
Source: DRC, RongViet Securities

Figure 2: Lower input costs will partly compensate selling prices reduction, limiting the decrease in gross margin (%)



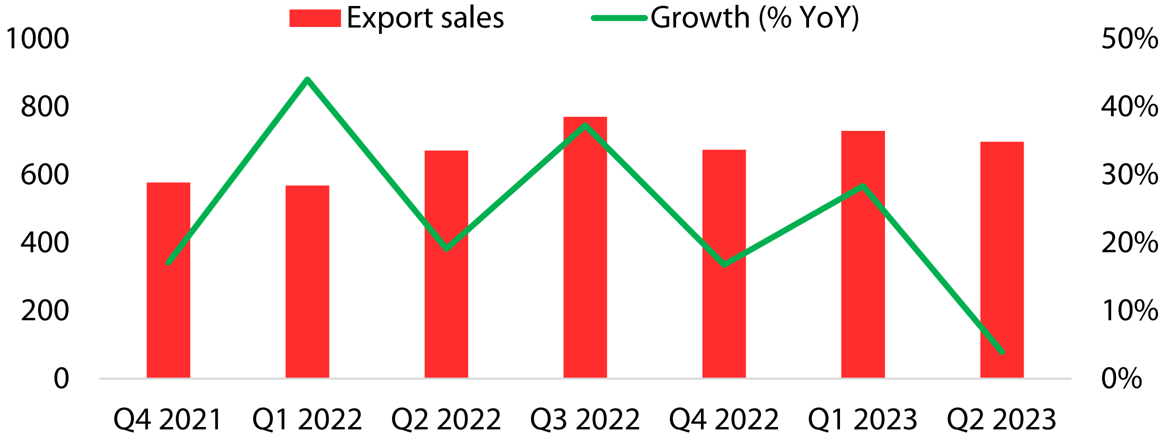
Source: DRC, RongViet Securities

Figure 3: The domestic selling volumes of truck s is expected to recover since 2H2023 (units)



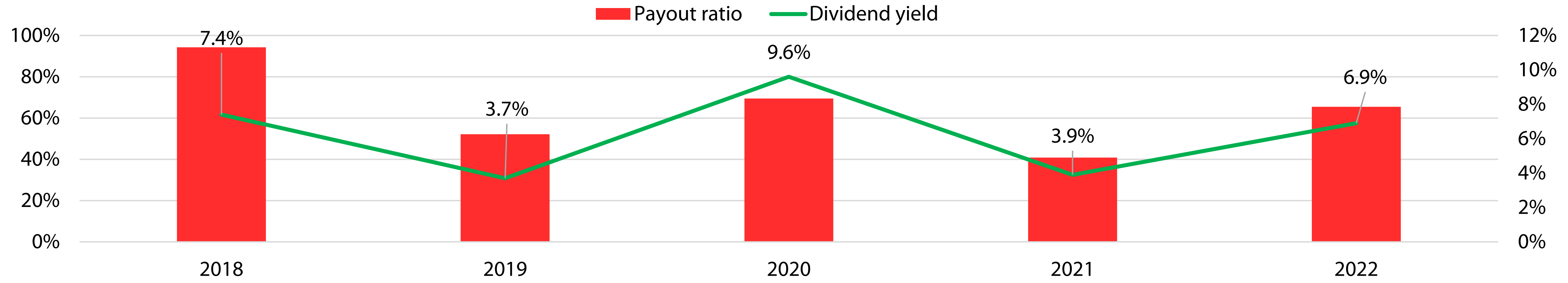
Source: DRC, RongViet Securities

Figure 4: The export revenue was stable during economic cycle – Export sales (VND bn, LHS) and Growth (% YoY, RHS)



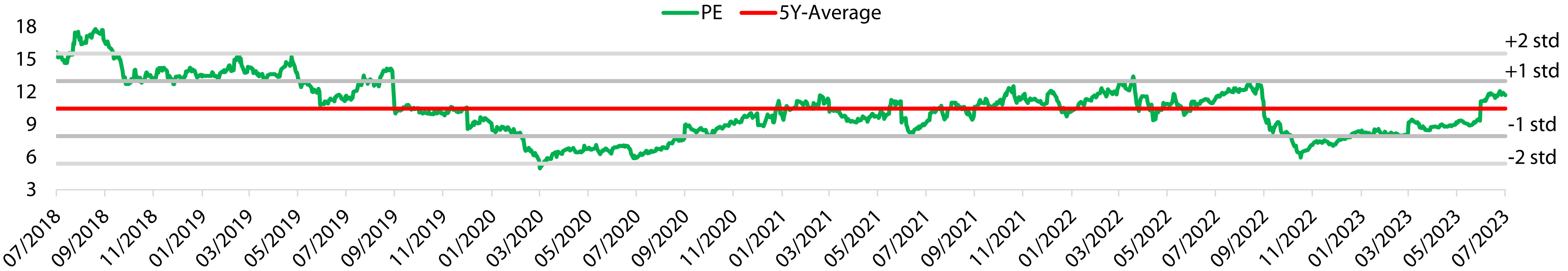
Source: DRC, RongViet Securities

Figure 5: DRC could be a suitable investment under the "dividend investing strategy" with stable cash payout ratio policy of over 40% per year and annual average dividend yield of over +5% - Payout ratio (%, LHS) and Average dividend yield (%, RHS)



Source: Bloomberg, RongViet Securities

Figure 6: DRC 'stock prices has recovered since mid-Jun 2023 on the expectation of DRC's performance will bottom out since 2H2023. The equivalent trailing P/E is 11.8x which is above 5Y-average P/E (10.4x) and reach the +1 std level of P/E band chart. Under the mixture outlook of 2023 negative growth and 2024 positive growth, we suppose that the positive catalysts of DRC shares almost reflected on the share price movement



Source: Bloomberg, RongViet Securities

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