

Hoa Phat Group (HPG – HSX)

On the way to dominate nationwide' market shares

Particulars (VND bn)	Q2-FY14	Q1-FY14	+/- qoq	Q2-FY13	+/- yoy
Net Revenues	6,513.9	6,515.5	0.0%	4,344.9	49.9%
EBIT	943.4	870.4	8.4%	511.6	84.4%
PAT	1,167.9	1,191.7	-2.0%	677.0	72.5%
EBIT margin (%)	17.9%	18.3%	-36bps	15.6%	235bps

Sources: HPG

- 1H2014: Comprehensive growth, HPG completed 82.4% its profit target this year.
- HPG competitive advantages over industry peers.
- Accelerating the presence of Hoa Phat Steel nationwide.
- The competitive strength against China steel.

Outlook and Valuation:

Based on positive sales of HPG in the first half of 2014, we revise our estimate of 2014 sales volume up by 10% compared to the previous. Gross profit margin is expected to increase to 20% as: (1) selling price will increase slightly in the rest of the year; (2) raw materials (HRC, scrap steel, coking coal) will drop more substantially as compared to our previous estimate; (3) the property segment may have higher profit margin in 2014. Thus, we re-estimate 2014 revenue at VND25,200 bn (+33% yoy) and NPAT at VND3,240 bn (+66% yoy). In August, HPG will issue 9.6 million shares under the ESOP, after which HPG's forward EPS is estimated at VND6,600.

We have also included the Steel Complex Phase III project into our valuation model and thus revise the target price for HPG from VND55,100 per share to **VND66,400** per share. HPG price has been steadied recently due to of portfolio rebalancing activities of BI Private Equity New Market II K/S Fund. At HPG's closing price as of 11/08/2014 of VND56,000 per share, we rate this stock as **ACCUMULATE** for the **INTERMEDIATE** term.

Key financials

Y/E Dec (VND bn)	2012	2013	1H2014	FY2014E	FY2015F
Net Revenues	16,826.9	18,934.3	13,029.4	25,205.2	25,089.0
% chg	-5.7%	12.5%	57.4%	33.1%	-0.5%
PAT	994.0	1,954.2	1,813.7	3,244.2	2,737.4
% chg	-19.6%	96.6%	87.3%	66.0%	-15.6%
EBIT margin (%)	5.9%	10.3%	13.9%	12.9%	10.9%
ROA (%)	5.4%	9.3%		14.1%	11.6%
ROE (%)	12.8%	22.2%		29.7%	20.7%
EPS (VND)	2,386	4,663		6,600	5,569
Adjusted EPS (VND)	2,332	4,559		6,732	5,569
Book value (VND)	16,646	22,671		25,155	28,745
Cash dividend (VND)	2,000	1,500		2,000	2,000
P/E (x)	8.8	8.8		8.5*	10.1*
P/BV (x)	1.3	1.8		2.2*	1.9*

Sources: HPG, RongViet Securities (*) Reference price as of 11/08/2014

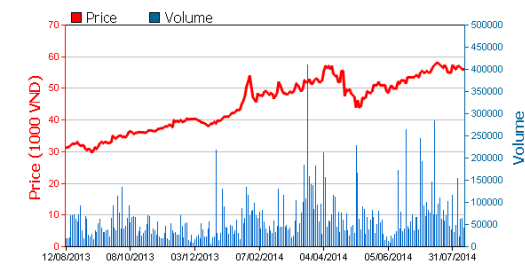
ACCUMULATE

CMP (VND)	56,000
Target Price (VND)	66,400

Investment Period Intermediate

Stock Info

Sector	General Industry
Market Cap (VND bn)	26,987
Current Shares O/S	481,928,433
Beta	1.18
Free float (%)	35.4
52 weeks High	58,000
52 weeks Low	24,700
Avg. Daily Volume (in 20 sessions)	624,090



Performance (%)

	3M	1Y	3Y
HPG	27.3	78.9	108.2
General Industry	12.6	12.9	NA
VN30 Index	13.3	16.0	52.9
HSX Index	16.4	20.5	56.6

Major Shareholders (%)

Tran Dinh Long	24.12
Vu Thi Hien	7.39
Deutsche Bank AG London	6.04
VOF investment, ltd	5.29
Foreign Investor Room (%)	5.08

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Exhibit 1: Q2-FY2014 and 1H2014 Results

Particulars (VND bn)	Q2-FY14	Q1-FY14	+/- (qoq)	Q2-FY13	+/- (yoy)	1H2014	+/- (yoy)
Net Revenues	6,513.9	6,515.5	0.0%	4,344.9	49.9%	13,029.4	57.4%
Gross profits	1,432.7	1,389.7	3.1%	835.8	71.4%	2,822.4	84.8%
SG&AC	215.8	220.7	-2.2%	129.4	66.8%	436.5	52.5%
Operating Income	1,217.0	1,169.0	4.1%	706.4	72.3%	2,385.9	103.0%
EBITDA	986.5	980.6	0.6%	830.6	18.8%	1,967.1	20.2%
EBIT	711.9	711.9	0.0%	677.0	5.2%	1,423.8	7.0%
Financial expenses	168.4	138.2	21.9%	170.1	-1.0%	306.6	14.4%
- Interest Expenses	81.4	120.8	-32.7%	77.7	4.7%	202.2	27.1%
Dep. and amortization	-274.6	-268.7	2.2%	-153.6	78.8%	-543.3	78.0%
Non-recurring Items (*)	107.0	227.0				334.0	
Extraordinary Items (**)	5.3	3.0	80.3%	-2.8	-289.5%	8.3	
PBT	1,086.6	1,070.8	1.5%	599.3	81.3%	2,157.4	84.2%
PAT	943.4	870.4	8.4%	511.6	84.4%	1,813.7	87.3%
(*) Adjusted PAT	863.1	868.1	-0.6%	514.1	67.9%	1,471.4	

Sources: HPG, RongViet Securities

(*) Profit from Mandarin Garden project

1H2014: Comprehensive growth, HPG completed 82.4% its profit target this year.

In the first half of 2014, construction steel and steel pipe consumption of HPG grew 38% and 30% yoy respectively. Company came out on top of the construction steel market earlier this year and has continued to hold its ground over the past six months. The Da Nang steel pipe plant went into operation in April, 2014 and has since contributed to steel pipe consumption growth. For abroad consumption, HPG has maintained steady billet exports to ASEAN countries such as the Philippines and Thailand. Now, the Company is trying to sell construction steel to Laos, Cambodia and Australia. In fact, a sample lot of rolled steel coil was shipped to Australia in June in order to survey the steel demand in this country. Besides, the recognition of revenue from Mandarin Garden continued to make up approximately 15% of revenue and 18% of NPAT in the first half of this year. Thus, 1H2014 results made an impressive growth wherein revenue was recorded at VND13,339 bn (+58.6% yoy) while NPAT for the parent company's shareholders was VND1,814 bn (+87% yoy) or 82.4% of the full-year profit guidance.

Exhibit 2: 1QFY2014 performance analysis

Particulars	Q2-FY14	Q1-FY14	+/- (qoq)	Q2-FY13	+/- (yoy)
Profitability Ratios (%)					
Gross Margin	22.0%	21.3%	67bps	19.2%	276bps
EBITDA Margin	15.1%	15.0%	9bps	19.1%	-397bps
EBIT Margin	10.9%	10.9%	0bps	15.6%	-465bps
Net Margin	14.5%	13.4%	112bps	11.8%	271bps
Adjusted Net Margin	13.3%	13.3%	-7bps	11.8%	142bps
Turnover *(x)					
-Inventories	3.0	2.8	0.2	2.0	1.1
-Receivables	19.7	16.6	3.1	10.5	9.2
-Payables	15.7	30.3	-14.7	23.9	-8.3
Leverage (%)					
Total Debt/ Equity	0.9	1.1	-0.2	1.3	-0.4

Source: Rong Viet Securities (*) Annualized turnover

HPG competitive advantages over industry peers.

HPG’s comprehensive growth and outstanding performance against its peer is the fruit of the decision to invest in a steel complex on the basis of a closed-end process line, including (1) ore exploitation, (2) coke production, (3) rough draft steel production and (4) finished steel production. We realize that HPG has the ability to earn added value or save costs at every step, specifically:

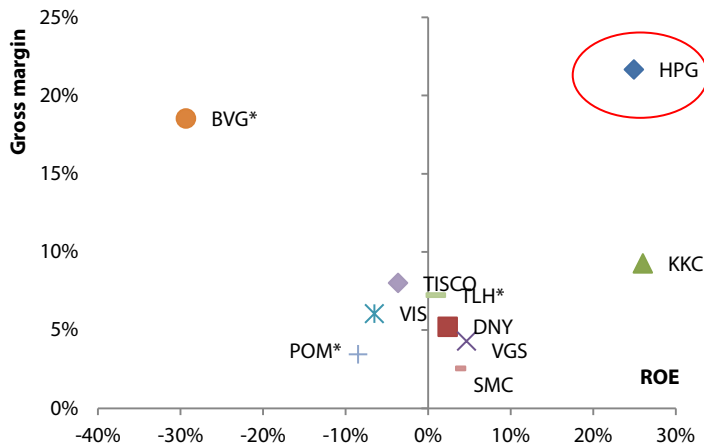
(1) Currently, HPG can self-supply 40% of its iron ore with its mines which can provide an approximately 50 million tons of ore in 20 years. The company does not disclose COGS of the self-produced iron ore, however, we suppose that HPG’ iron ore price may be lower by 10-15% compared to market price.

(2) The company has up to 700,000 tons of coke at its disposal each year thanks to the ownership of its own coke factory, the largest of its kind in the country given the plants using the same BOF technology of TISCO and Viet Trung for comparison. The company also utilizes the excess heat in coke production to generate electricity a cost of ½ the average electricity price for steel plants.

(3) Since the Steel Complex Phase II came into operation, HPG has begun to export semi-finished products to the ASEAN market now that domestic construction steel demand is still limited. Billets sales seemed quite optimistic in the first half of 2014 that it helped HPG both reduce its inventory and collect currencies for its material import needs.

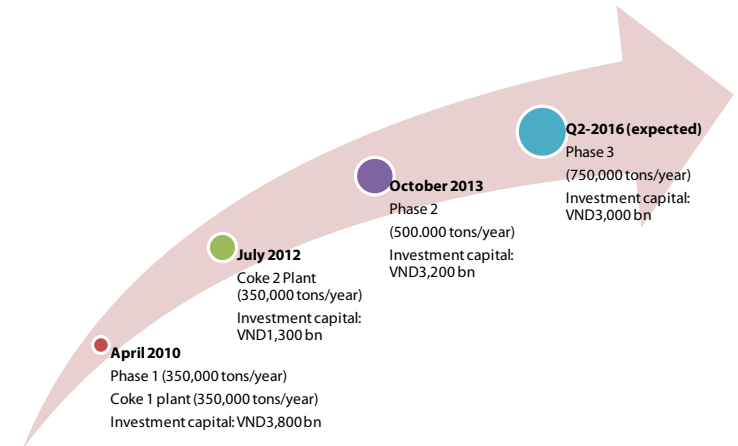
(4) Another advantage of HPG is the ability to reduce transportation cost through the use of internal ports that have a total capacity of 100,000 tons/year and a close proximity (~35 km) to Hai Phong Port, the largest sea transport hub in the North.

HPG effectiveness compared to its peers



Sources: RongViet Securities, as of Q2/2014; (*): Q1/2014

HPG’ investment progress



Sources: HPG, RongViet Securities

Based on current advantages, HPG intended to develop the Integrated Steel Complex – Phase III with capacity about 750,000 tons of steel each year and total investment of approximately VND3,000 bn, which will start construction in Sep, 2014 and finish 18 months later. At the moment, we saw several elements favoring this decision. First of all, the success of Mandarin Garden has helped the Company gain a solid financial standing to support more investment. Secondly, in the context of low inflation and decreased raw material price, we think new investment will be less risky. Lastly, we see that company has positive outlook about steel demand after Integrated Steel Complex – Phase III starts running (estimated time of completion Q2/2016), the time we can expect the property market has begun to pick up speed. The Company said this year and 2015 would mark HPG’s first steps out of the domestic

market; hence, there is a high probability that Phase III's products will be mostly for external consumption.

Investment capital for Phase III may come mainly from equity capital, which is unusual for steel company but we think possible for the case of HPG given financial strength. At the end of 2Q2014, the debt/asset ratio of HPG was posted 47.2%, down significantly as compared to the figure of 58.3% a year earlier. Equity-funded new investments will create an advantage of financial expense for HPG as compared to its peers. Under lasting difficulties of the steel industry, we believe two decisive factors of success are cost savings and healthy financials; and HPG now has both.

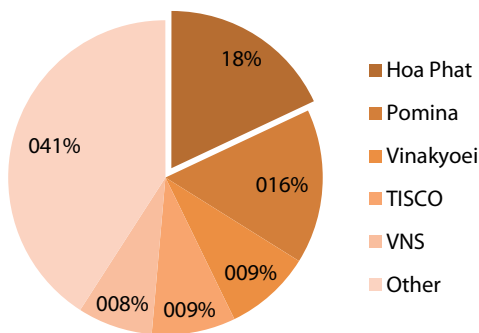
Accelerating the presence of Hoa Phat Steel nationwide

Local steel demand has weakened in recent years due to the slowdown of the economy and competition has grown as the result. The market landscape has also changed significantly. Whereas small-scale and financially incompetent firms have been gradually eliminated, state-owned companies (VNSteel and its joint-ventures) lost their market shares to those in the private sector.

In the market share map, state-owned firms are clearly divided by consumption region: in the Northern region is TISCO; in the South are Nha Be, Bien Hoa, Thu Duc Steel and Vinakyoei; then there are VPS, Vinausteel and Natsteelvina in mid-country. Still, private companies like HPG and POM now dominate both the Northern and the Southern markets. HPG steel consumption in Northern and Mid-country areas is relatively low now (average ~7,500 tons/month). However, we see factors that can help the Company expand its market share in the North which are: (1) production cost advantages, (2) the cost of water transportation from the Complex to HCMC well below the cost of transporting by road at only VND500,000/ton, (3) another depot in Binh Duong to be built to support for steel distribution in Southern areas.

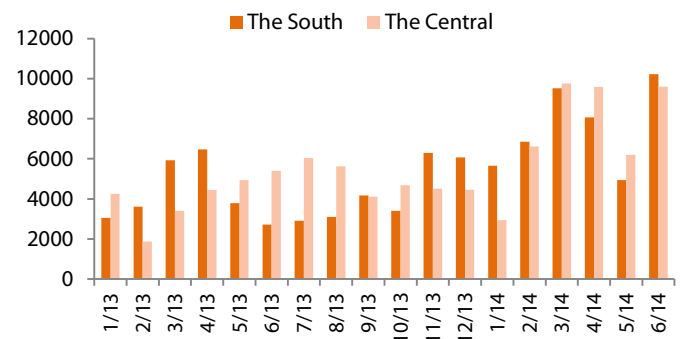
In 2014, HPG planned to double the sales volume in the South and triple that in the Central. In the first half of this year, consumption volume on both areas reached about 45,000 tons, up ~77% and ~84% yoy, respectively. Upon tracking HPG' sales in these areas, we expect the Company to achieve its sales goal in the South; yet things will be much more difficult in the Central.

Steel industry market shares in 1H2014



Source: VSA

Sales volume in the South and Central of HPG



Source: VSA

The competitive strength against China steel

Excessive supply of China steel has been a growing concern among domestic steel firms since 2010. In the end of 2013, both the joint Ministry of Industry & Trade and Science & Technology issued Circular No.44, effective June 2014, to regulate the quality of domestic and imported steels. We see this legislation particularly important in that it would keep low-priced Chinese steel from flooding the market while supporting domestic players, including HPG.

In a regional competitive analysis, we realize that the production cost advantage remains one of the most important factors deciding the competitiveness of Hoa Phat steel products. According to Bloomberg statistics, the cost to produce a ton of Chinese blast-furnace (BF) steel is about VND10.1 million and our COGS estimate for Hoa Phat is only 5% higher. The Company is exporting rough draft steel at a price of approximately 500USD/ton, 4.2% higher than the Chinese products. Under such analysis, it is clear to us that the Company will have no problem maintaining its competitiveness against Chinese low-price steel and ensuring profitability.

Outlook and valuation

Based on positive sales of HPG in the first half of 2014, we revise our estimate of 2014 sales volume up by 10% compared to the previous. Gross profit margin is expected to increase to 20% as: (1) selling price will increase slightly in the rest of the year; (2) raw materials (HRC, scrap steel, coking coal) will drop more substantially as compared to our previous estimate; (3) the property segment may have higher profit margin in 2014. Thus, we re-estimate 2014 revenue at VND25,200 bn (+33% yoy) and NPAT at VND3,240 bn (+66% yoy). In August, HPG will issue 9.6 million shares under the ESOP, after which HPG's forward EPS is estimated at VND6,600.

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Exhibit 3: Key Assumptions

Particular	Earlier Estimates		Revised Estimates	
	FY2014E	FY2015F	FY2014E	FY2015F
Revenue growth (%)	31.2%	-3.3%	33.1%	-0.5%
Steel volume growth (%)	20.0%		31.8%	
Gross margin (%)	16.6%	17.6%	20.0%	18.9%
EBIT margin (%)	13.7%	14.5%	17.2%	15.2%

Source: RongViet Securities

Exhibit 4: Changes in Estimates

Particular (VND bn)	FY2014E			FY2015E		
	Earlier Estimates	Revised Estimates	Var (%)	Earlier Estimates	Revised Estimates	Var (%)
Net Revenues	24,849.1	25,205.2	1.4%	24,017.1	25,089.0	4%
Gross profits	16.6%	20.0%	338bps	17.6%	18.9%	134bps
SG&AC	866.7	879.1	1.4%	936.7	978.5	4%
Operating Income	3,260.7	4,159.9	27.6%	3,279.2	3,760.8	15%
Financial expenses	492.7	380.6	-22.8%	557.2	492.0	-12%
PBT	3,034.2	3,985.5	31.4%	3,058.4	3,436.1	12%
PAT	2,514.4	3,244.2	29.0%	2,525.2	2,737.4	8%
EBITDA	4,413.2	5,369.2	21.7%	4,479.2	4,848.0	8%
EBIT	3,413.2	4,331.5	26.9%	3,487.0	3,814.6	9%
EPS (VND)	5,217	6,600	26.5%	5,240	5,569	6%

Source: RongViet Securities

VND Billion

INCOME STATEMENT	FY2012	FY2013	FY2014E	FY2015F
Revenue	16,826.9	18,934.3	25,205.2	25,089.0
COGS	14,341.6	15,650.5	20,166.2	20,349.8
Gross profit	2,485.2	3,283.8	5,039.0	4,739.2
Selling Expense	274.0	253.7	324.6	376.3
G&A Expense	587.0	416.2	554.5	602.1
Finance Income	164.6	276.3	161.7	116.3
Finance Expense	585.0	528.4	380.6	492.0
Other profits	14.9	32.9	44.5	51.1
PBT	1,218.2	2,394.4	3,985.5	3,436.1
Prov. of Tax	187.7	384.0	581.9	515.4
Minority's Interest	36.5	56.2	159.4	183.3
PAT to Equity Shareholder	994.0	1,954.2	3,244.2	2,737.4
EBIT	1,745.2	2,765.4	4,331.5	3,814.6
EBITDA	2,341.4	3,485.5	5,369.2	4,848.0

%

FINANCIAL RATIO	FY2012	FY2013	FY2014E	FY2015F
Growth				
Revenue	-5.7%	12.5%	33.1%	-0.5%
Operating Income	-27.9%	60.9%	59.1%	-9.6%
EBITDA	-16.3%	48.9%	54.0%	-9.7%
EBIT	-22.6%	58.5%	56.6%	-11.9%
PAT	-19.6%	96.6%	66.0%	-15.6%
Total Assets	8.5%	21.4%	-0.5%	5.8%
Equity	9.1%	17.5%	30.1%	14.3%
Internal growth rate	0.3%	15.1%	20.7%	13.2%
Profitability				
Gross profit/Revenue	14.8%	17.3%	20.0%	18.9%
Operating profit/ Revenue	9.7%	13.8%	16.5%	15.0%
EBITDA/ Revenue	13.9%	18.4%	21.3%	19.3%
EBITDA/ Revenue	10.4%	14.6%	17.2%	15.2%
Net margin	5.9%	10.3%	12.9%	10.9%
ROAA	5.4%	9.3%	14.1%	11.6%
ROIC or RONA	15.5%	23.4%	33.5%	25.8%
ROAE	12.8%	22.2%	29.7%	20.7%
Efficiency				
Receivable Turnover	9.5	11.6	14.1	13.5
Inventory Turnover	2.2	2.1	2.6	2.7
Payable Turnover	6.2	4.0	4.2	5.3
Liquidity				
Current	1.4	1.1	1.4	1.3
Quick	0.5	0.4	0.5	0.4
Solvency				
Total Debt/Equity	129.1%	142.0%	84.7%	71.0%
Current Debt/Equity	60.0%	60.5%	39.5%	36.3%
Long-term Debt/ Equity	18.0%	19.3%	11.2%	8.7%

VND Billion

BALANCE SHEET	FY2012	FY2013	FY2014E	FY2015F
Cash and equivalents	1,294.5	2,125.3	2,293.9	959.9
Short-term investment	220.0	387.8	349.0	314.1
Receivables	1,646.3	1,629.4	1,955.3	1,759.8
Inventories	6,822.1	8,029.6	7,434.2	7,805.9
Other current assets	237.9	230.4	207.4	217.7
Total Current Asset	10,220.8	12,402.5	12,239.8	11,057.4
Tangible Fixed Assets	4,295.8	8,864.5	9,224.5	10,484.5
Intangible Fixed Assets	166.2	189.1	184.3	179.5
Construction in Progress	2,545.1	133.6	746.0	2,000.0
Investment Property	66.5	62.0	174.5	190.8
Long-term Investment	26.2	21.3	21.1	21.1
Other long-term assets	843.1	830.6	374.0	366.5
Commercial Interest	852.1	572.9	472.9	372.9
Long-term Asset	8,795.0	10,673.9	10,724.3	13,242.5
Total Asset	19,015.8	23,076.4	22,964.1	24,299.9
Payables	1,708.2	2,393.6	2,218.3	2,238.5
Other current liabilities	803.5	3,005.3	1,906.3	1,366.6
Current Debt	4,850.2	5,743.6	4,882.0	5,126.1
Long-term Debt	1,455.7	1,831.8	1,381.8	1,225.1
Other long-term liabilities	1,620.5	515.1	88.4	79.6
Total Liability	10,438.2	13,489.4	10,476.9	10,035.9
Owner's Equity	8,085.1	9,500.3	12,364.4	14,128.9
Capital	4,190.5	4,190.5	4,915.3	4,915.3
Retained Earnings	1,392.7	2,643.4	4,743.6	6,443.2
Funds & Reverses	290.1	459.1	498.2	563.0
Others	0.0	0.0	0.0	0.0
Total Equity	8,085.1	9,500.3	12,364.4	14,128.9
Minority's Interest	492.4	86.6	122.9	135.1
TOTAL RESOURCES	19,015.8	23,076.4	22,964.1	24,299.9
CASH FLOW STATEMENT	FY2012	FY2013	FY2014E	FY2015F
Profit before tax	1,218.2	2,394.4	3,985.5	3,436.1
-Depreciation	596.2	720.2	937.7	933.5
-Adjustments	616.2	268.2	58.5	63.2
+/- Working capital	-161.2	-148.9	-1,541.4	-1,230.3
Net Operating CFs	2,269.4	3,233.8	3,440.4	3,202.5
+/- Fixed Asset	-1,776.7	-2,909.7	-2,017.8	-3,459.1
+/- Deposit, equity investment	134.1	-46.9	7.7	7.5
Interest, dividend, cash profit received	-17.2	-295.9	0.0	0.0
Net Investing CFs	-1,659.7	-3,252.5	-2,010.1	-3,451.6
+/- Capital	100.5	0.6	724.8	0.0
+/- Debt	-118.3	1,269.4	-1,270.1	124.1
Dividend and others paid	-361.8	-420.5	-716.4	-1,209.1
Net Financing CFs	-379.6	849.5	-1,261.7	-1,084.9
+/- cash & equivalents	230.1	830.9	168.6	-1,334.0
Beginning cash & equivalents	1,064.4	1,294.5	2,125.3	2,293.9
Impact of exchange rate	0.0	-0.1	0.0	0.0
Ending cash & equivalents	1,294.5	2,125.3	2,293.9	959.9

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 which 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 / Return Potential	BUY	ACCUMULATE	NEUTRAL	REDUCE	SELL
Intermediate- term (up to 6 months)	>20%	10% to 20%	-5% to 10%	-15% to - 5%	<-15%
Long-term (over 6 months)	>30%	15% to 30%	-10% to 15%	-15% to -10%	<-15%

ABOUT US

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