RONG VIET SECURITIES

POWER INDUSTRY: 2H 2019 Outlook Supports Thermal Power Plants

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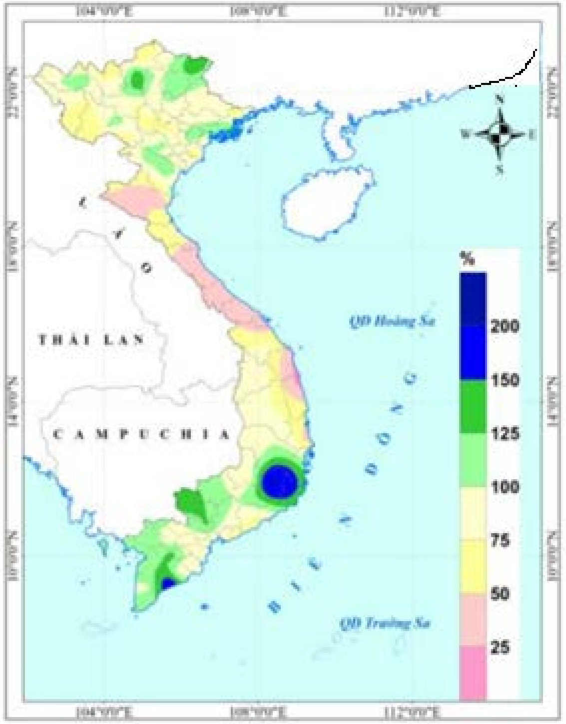
POWER INDUSTRY - REVIEW

Weak hydropower supply, but market price remained flat in 1H 2019

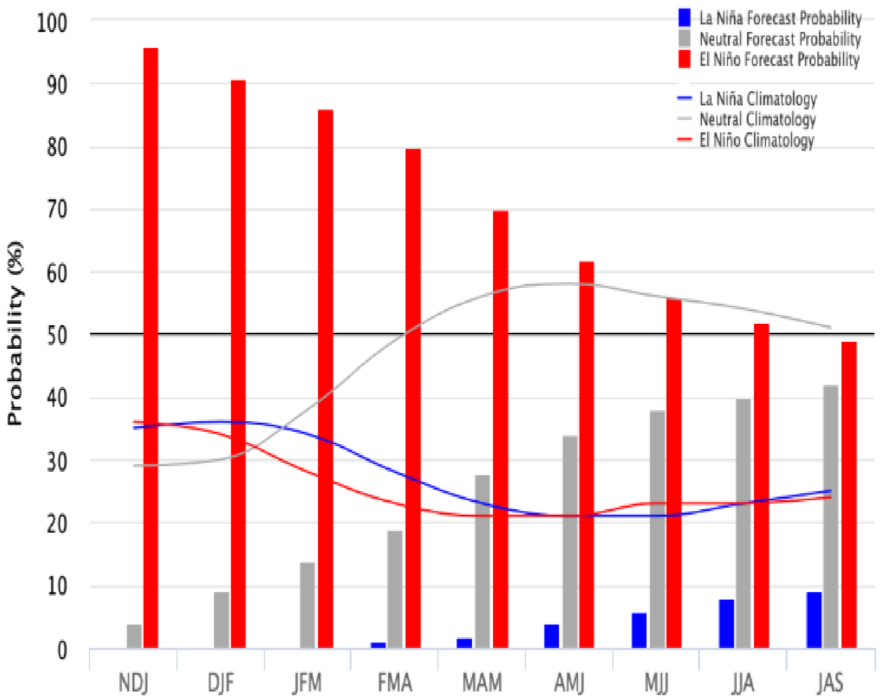
- **Hydropower was weak in 1H 2019** as:
  - o Gas and coal shortage in late 4Q 2018 forced EVN to mobilize heavily in hydropower groups, resulting in low level of water reserve at the beginning of 2019.
  - o Due to impact from El Nino conditions, the amount of rainfall was below multi-year average level, especially in 2Q 2019.
- However, the change in policies related to competitive market price (CGM) made it remain flat in 1H 2019. Therefore, **thermal power did not benefit from low hydropower supply**; some thermal power plants (PPC, PGV, NT2, HND) even witnessed a decline in sales volume.

Figure 1: The amount of rainfall in 1H 2019 compared to multi-year average level



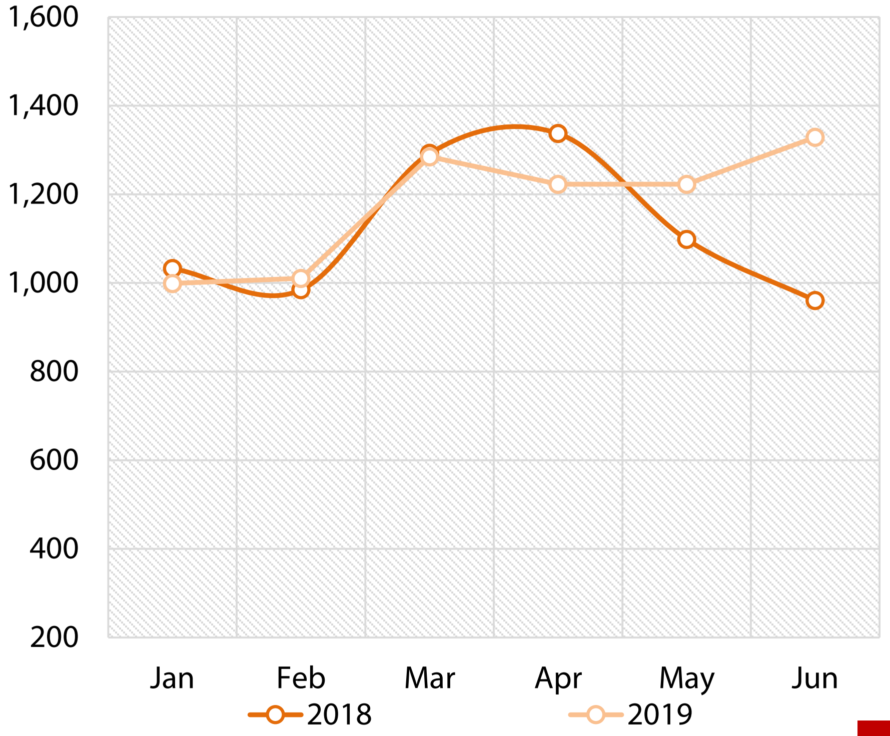
Source: Vietnam National Centre for Hydrometeorological Forecasting

Figure 2: Probabilistic ENSO forecasts from December 2018



Source: NOAA, Rong Viet Securities

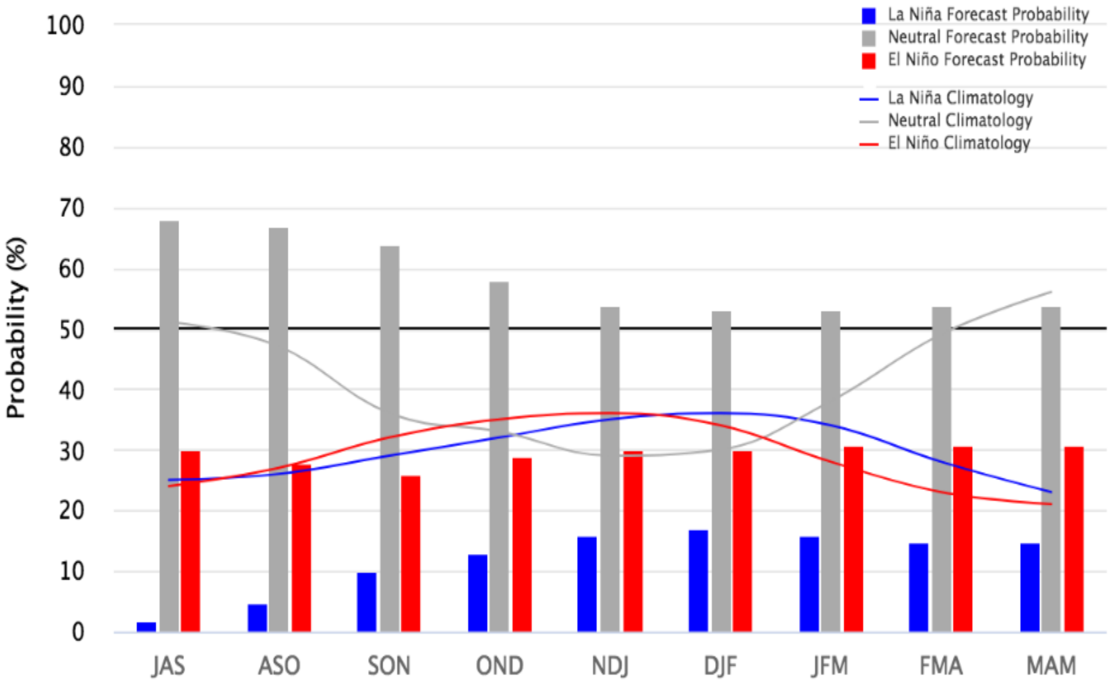
Figure 3: Competitive market (CGM) price in 1H 2018-2019 *(VND/kWh)*



Source: EVN, Rong Viet Securities

Limited power supply despite large new additional capacity of solar power in the recent periods will support CGM price in 2H 2019

Figure 4: Probabilistic ENSO forecasts from Aug 2019 onwards



Source: NOAA, Rong Viet Securities

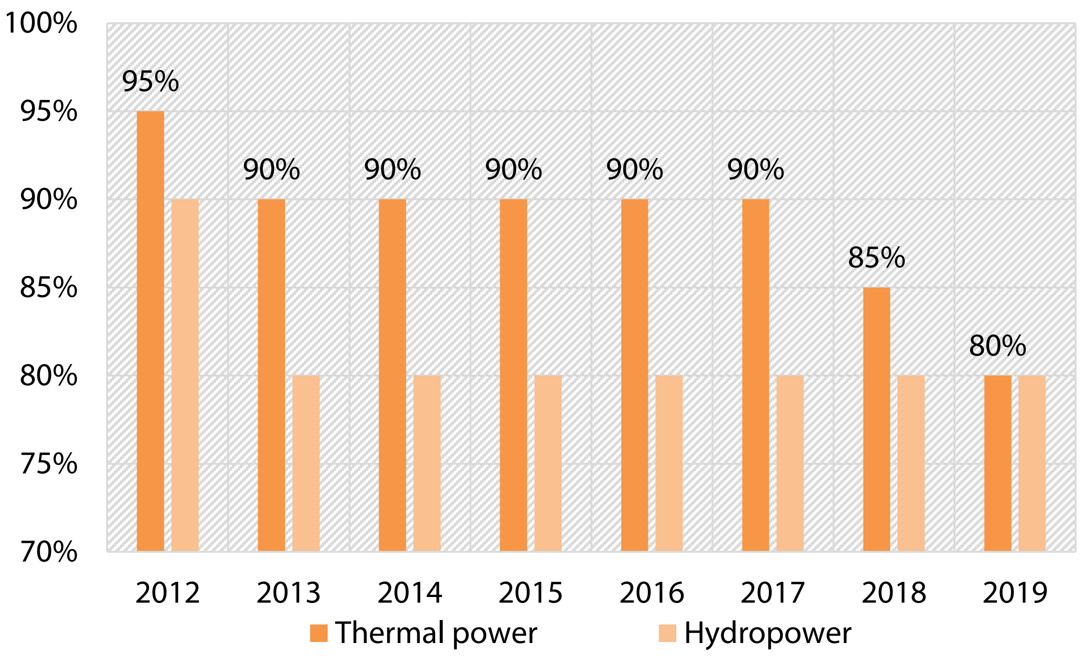
- **Hydropower and gas supply in 2H 2019 is expected to remain limited**
  - According to National Ocean Atmosphere Administration (NOAA), probability of neutral climate is over 50% in the following year from early August 2019. Therefore, in 2H 2019, weather will be neutral.
  - According to EVN, the total amount of water reserve in hydropower plants at the end of 2Q 2019 was 80% lower than normal level, equivalent to 12.49 billion kWh.
  - According to EVN, gas supply to Ca Mau power plant, a major power generator in the South, will witness a strong decline in 4Q 2019, resulting in another constrain in power supply in the region.
- **In addition, solar power still contributes marginal share to National power supply (2.3%),** and thus cannot compensate for the shortfall of hydropower and gas-fired power supply.
- **Limited power supply strongly supports CGM price in 2H 2019**
  - Power plants, which have adequate input supply, will be able to capitalize on favorable market conditions. Most thermal power plants that we follow, except for Vung Ang 1 TPP, have arranged adequate coal supply for 2H 2019 production, implying positive outlook on 2H 2019 core earnings.

Lower contract volume (Qc) and the increase in input price put huge pressure on earnings of thermal power group in 1H 2019.

- As a result of electricity liberalization progress, Qc ratio (alpha) reduced from 95% in 2012 to 80% in 2019, and keep decreasing to 60% in the long term, leading to a downtrend in contract volume (Qc) of thermal power plants. This situation has negatively affected thermal power plants as their PPA prices are usually higher than CGM prices.

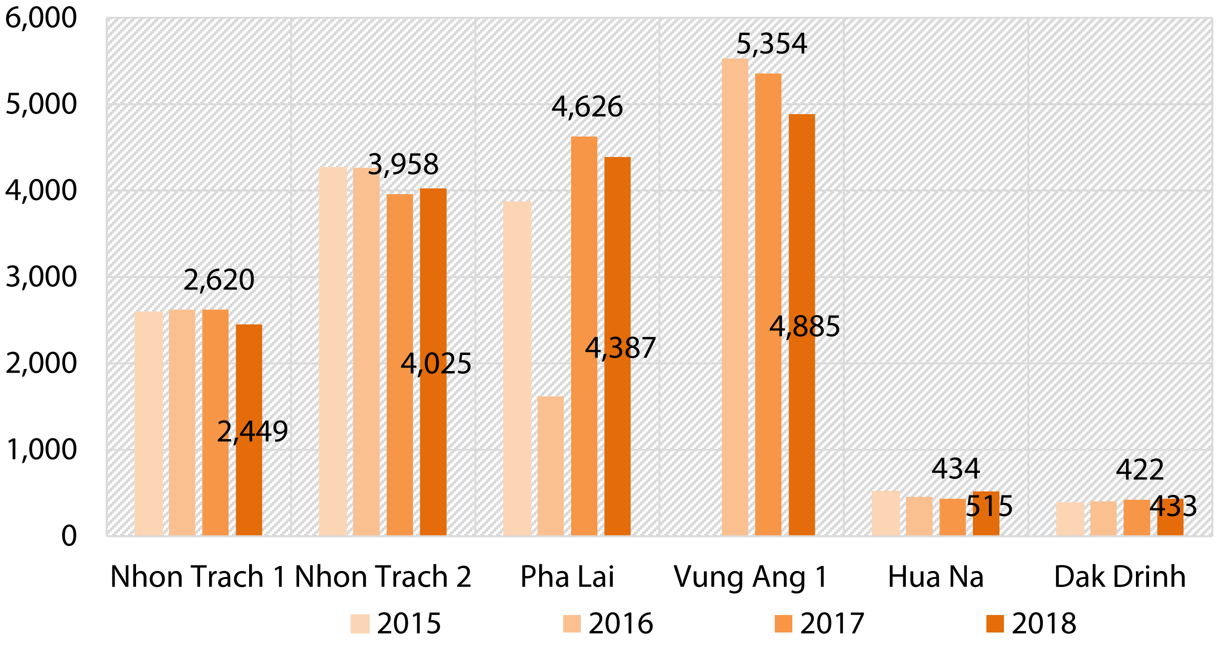
- In addition to the a 5% increase in 1H 2019 domestic coal price, there was also a coal shortage extended from 4Q 2018 to 1H 2019. As a result, the larger proportion of imported coal, which has higher price than domestic coal, even intensify the rise in coal price for thermal power plants. For example: PPC (+10%), HND (+14%).

Figure 5: Qc ratio (%) in 2012-2019



Source: EVN, Rong Viet Securities

Figure 6: Contract volume (Qc) in 2015-2018 *(million kWh)*



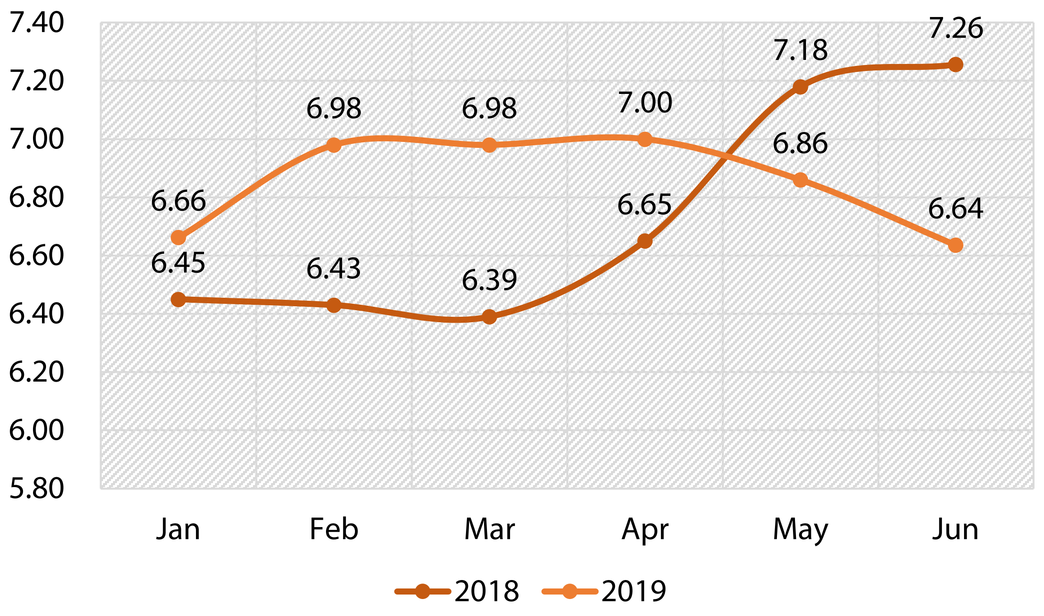
Source: EVN, Rong Viet Securities complied

Lower contract volume (Qc) and the increase in input price put huge pressure on earnings of thermal power group in 1H 2019

- In addition, gas supply in the Southeast regions also witnessed a slight increase in 1H 2019. Gas supply from old gas fields with low price goes down, the Southeast area has to purchase gas from gas fields with higher price

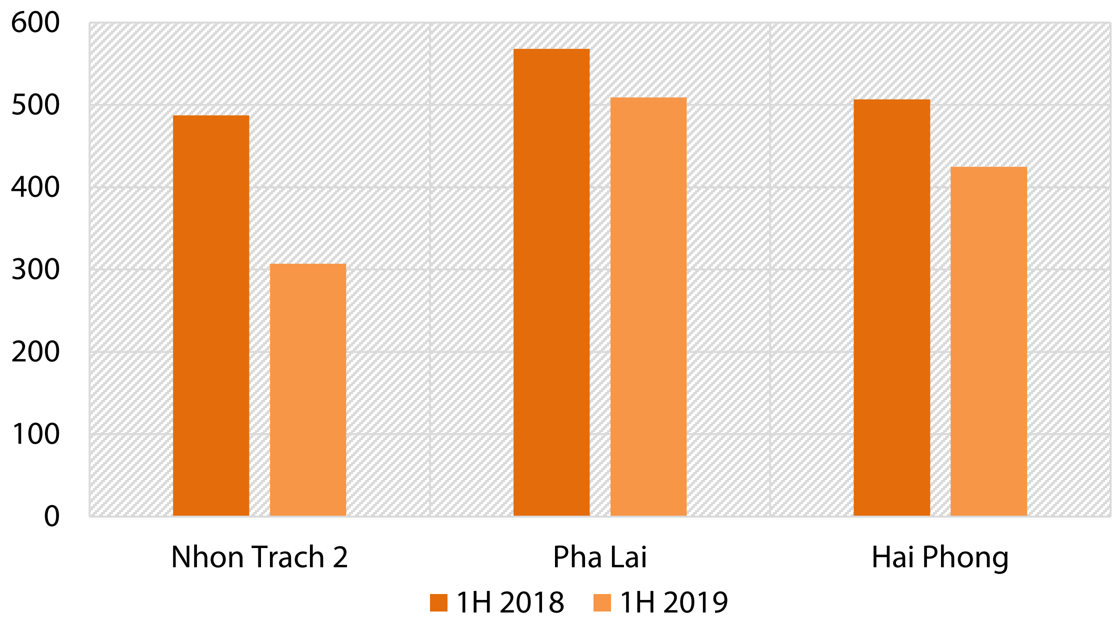
=> From three above-mentioned reasons, 1H 2019 core earnings of most thermal power plants witnessed a decline.

Figure 7: Gas price of NT2 in 1H 2019 *(USD/mmBTU)*



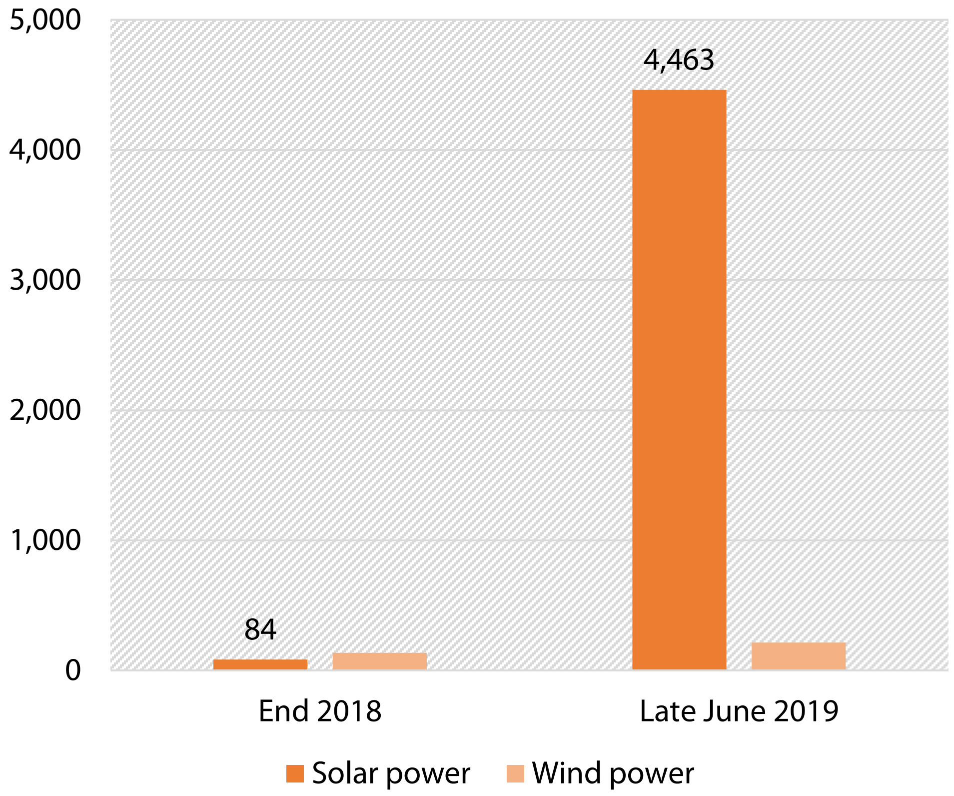
Source: NT2, Rong Viet Securities

Figure 8: Core earnings of thermal power plants in 1H 2018 and 1H 2019 *(billion VND)*



Source: Rong Viet Securities

Figure 9: Capacity of renewable power in end of 2018 and late June 2019 (MW)



Source: Rong Viet Securities

Solar power was "hot" in 1H 2019 but will cool down in 2H 2019

The market witnessed the participation of a large number of solar power plants in 1H 2019

- As solar farms coming online before June 2019 were eligible to enjoy favorable feed-in-tariff (FiT) mechanism, 87 out of 89 new renewable plants coming into operation in 1H 2019 were solar farms.
- Total capacity and daily output of solar power at the end of June 2019 reached 4,463 MW and 16,4 million kWh, accounting for 8.3% and 2.3% of figures of National Power System, respectively.

We expect small number of solar power plants, will come into commercial operation in 2H 2019 as:

- The new FiT mechanism for solar power plants after 30 June 2019 has yet been finalized. Therefore, solar power projects are pending to wait for official price.
- The new 2017 Planning Law has fundamental changes in planning approval procedures. As a result, no new power projects were added to the National Power Development Plan in 1H 2019. As we expect that the issue will not be solved soon in 2019, new power projects that are still out of the Plan will continue pending in 2H 2019.

The overload in transmission grid line that limits operation capacity of some renewable power projects is unrepresentative of overall situations of renewable energy.

- The over capacity only happened in some specific units in transmission grid lines of Ninh Thuan and Binh Thuan provinces.
- Among companies in our coverage list, Cu Jut solar power plant of CHP is located in Dak Nong. Meanwhile, GEG only has one solar power plant in Binh Thuan, but the plant is not affected by the above-mentioned units.

POWER 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
POW	9.9	-9.7	23.3	11.3	-15.5	5.8	0.7	6.7	3.2	7.6
NT2	5.7	-16.9	19.6	10.5	-22.5	8.7	0.0	11.2	7.4	16.9
PPC	-0.6	25.1	15.2	14.7	1.5	14.0	0.5	12.4	13.2	17.2
CHP	-3.3	1.3	75.1	46.0	-11.4	29.4	45.7	8.3	5.2	9.9
REE	2.9	-7.6	20.9	19.6	5.1	31.6	6.7	6.5	10.1	18.1
VSH	-35.6	-45.3	61.7	41.2	-55.3	39.2	276.6	2.0	2.0	5.2
HND	4.7	-4.1	34.4	14.9	7.4	4.5	0.1	9.9	2.9	7.8
SHP	-1.3	-1.9	75.9	44.8	-3.9	29.3	2.2	12.1	7.7	15.7

POW – Long-term Outlook remains attractive

INVESTMENT RATIONALES

- **Stable growth in power demand and limited new supply are supporting factors for existing power plants in the middle term**
  - Power consumption is expected to maintain double digit growth in 2019-2030 period. Meanwhile, many power projects in the national PDP are still behind the schedule. Therefore, there would be a rising electricity shortage of about 3.7 billion kWh in 2021 to a peak of nearly 12 billion kWh in 2023.
- **POW owns huge plants portfolio concentrated in the key economic region in the South**
  - Most above-mentioned electricity shortage is expected to occur in the South, while 64% of POW's total capacity is located there. Hence, these power plants would be in the top priority to be mobilized at the high level and even face low competition pressure in the rainy season.
- **Young plant fleet with advanced technology ensures stable operation**
  - All four gas-fired power plants of POW use modern combined-cycle gas turbine with high power generation efficiency and low heat rate.
- **Low investment capex and strong cash flows help POW strengthen financial soundness for new projects; while the firm still pays cash dividend**
  - Average capex per MW capacity of POW's portfolio is only 0.8 mn USD/MW.
  - Thanks to large reduction in depreciation expense and completion of debt payment (Ca Mau, NT1), POW would witness a significant improvement in both earnings and cash flows in 2019-2020.

RISK TO OUR CALLS

- Risks of changes in regulation and policies
- Risks of input materials supply for thermal power plants
- Risks of volatility in exchange rate

BUY 42%

CMP (VND)	**12,900**
Target price (VND)	**18,000**
Cash dividend in 12 months	*300*

STOCK INFO	
Sector	Utilities
Market Cap ($ mn)	1,297
Current Shares O/S (mn shares)	2,342
3M Avg. Volume (K)	2,411
3M Avg. Trading Value (VND Bn)	36.5
Foreign Ownership (%)	14.9
State Ownership (%)	79.9

FORECAST	2017A	2018A	2019F	2020F
Revenue	29,710	32,663	34,111	40,249
Growth (%)	5.3	9.9	4.4	18.0
NPATMI	2,233	1,676	2,441	3,016
Growth (%)	107.8	-25.0	45.7	23.5
ROA (%)	3.7	2.9	4.6	5.7
ROE (%)	9.0	6.8	9.3	10.6
EPS (VND)	1,014	749	1,038	1,282
Book Value (VND)	11,437	10,474	11,169	12,098
Cash dividend (VND)	0	0	300	300
P/E (x)	14.2	21.4	12.9	10.4
P/B (x)	1.1	1.4	1.2	1.1

POW – Ca Mau 1&2 power plant was "savior" of 1H 2019 earnings

- 1H 2019 NPATMI grew by 26% YoY, mainly driven by the VND 375 billion reduction in depreciation expense of Ca Mau 1&2 power plant.
- Vung Ang 1, Hua Na and Dakdrinh power plants witnessed a decline in 1H 2019 sales volume as:
  - Coal shortage decreased sales volume of Vung Ang 1 power plant to 2,770 billion kWh.
  - Unfavorable hydrological conditions made sales volume of Dakdrinh and Hua Na power plants decrease.

Figure 1: Sales volume of POW's power plants *(million kWh)*

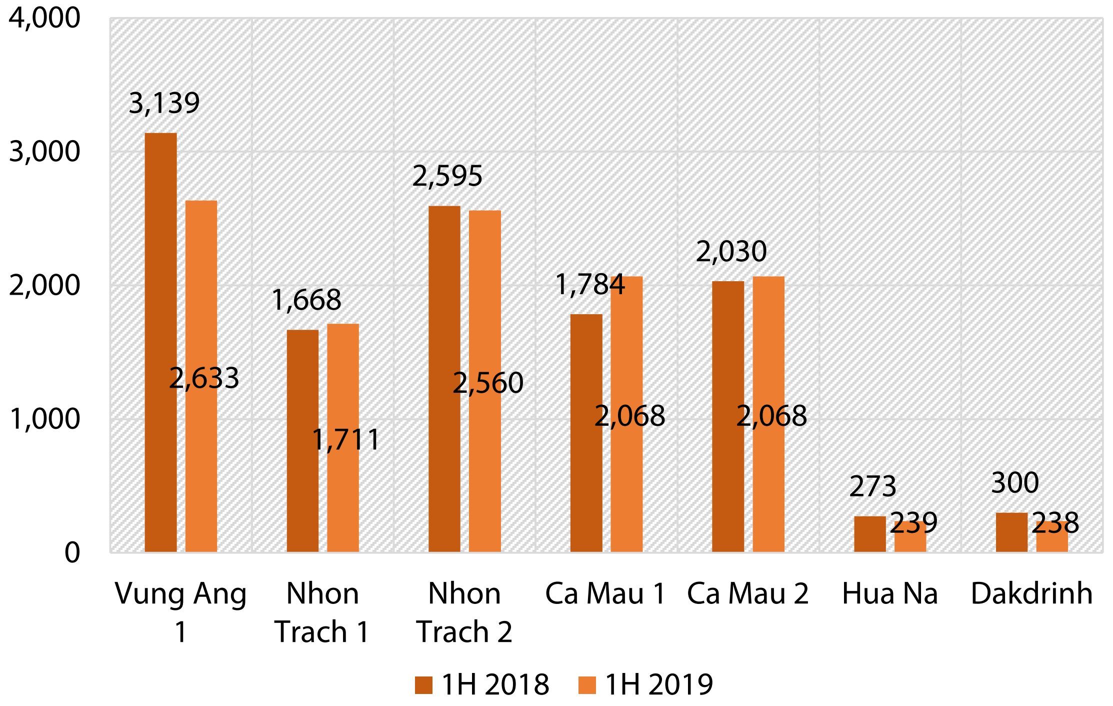
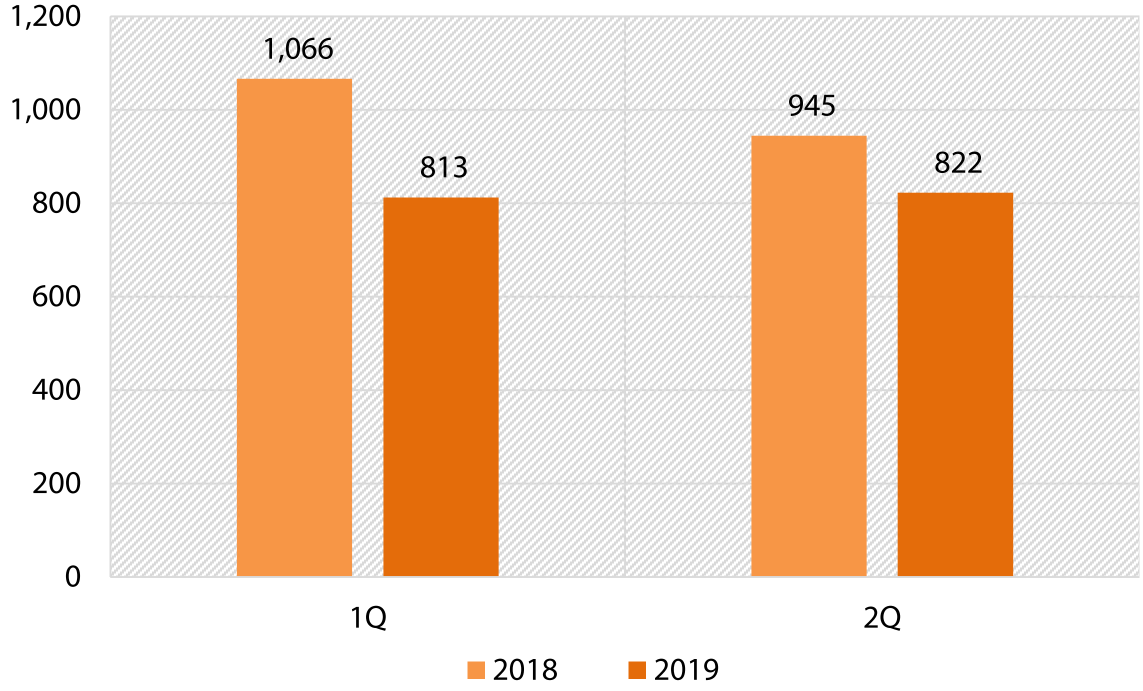


Figure 2: Depreciation expense of POW *(billion VND)*



Source: POW, Rong Viet Securities

POW – Besides the reduction on depreciation expense, an increase in sales volume would be another catalyst for 2H 2019 POW's performance

Figure 3: Sales volume of POW's power plants *(million kWh)*

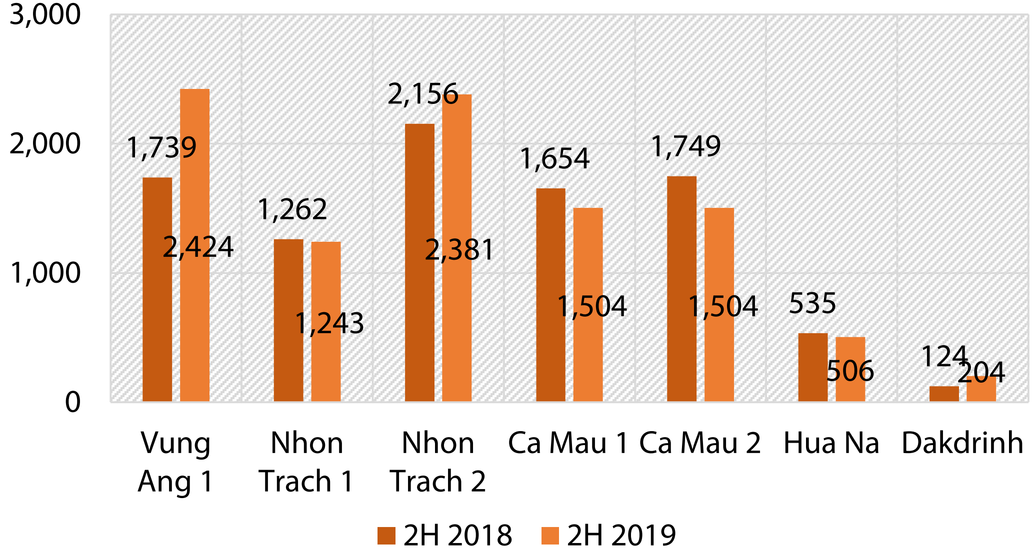
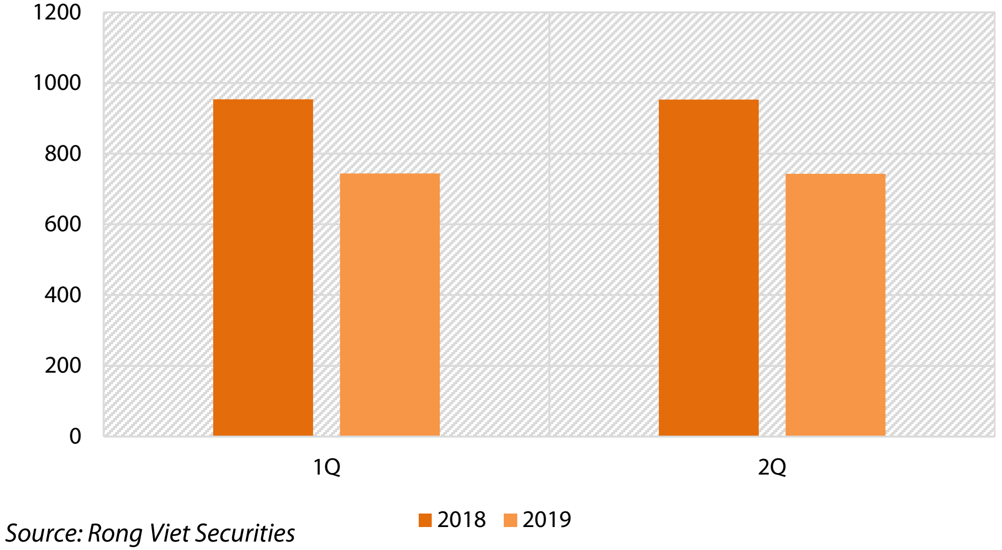


Figure 4: Depreciation expense of POW *(billion VND)*



Source: Rong Viet Securities

- **The improvement in sales volume of key power plants would support POW's operating profits in 2H 2019**
  - Sales volume of Vung Ang 1 power plant is expected to increase from the low base in 1H 2018, when the plant had intermediate overhaul and an 51% increase in 2H 2019 Qc
  - Sales volume of Nhon Trach 2 power plant would increase due to strong demand from the system, higher CGM price and higher Qc.
  - Sales volume of Ca Mau 1&2 power plant would decrease due to reduction in gas supply from PM3CAA lot of Cuu Long basin. However, due to special power purchasing mechanism of this plant, its earnings will face marginal impact from sales volume reduction.
  - As Dakdrinh hydropower plant stopped operation in November and December last year, we expect that normal operation of the plant in 2H 2019 will support its sales volume to improve.
- **Lower depreciation expense in Ca Mau 1&2 and Nhon Trach 1 power plants continues to be the catalyst in the 2H 2019**
  - We forecast that depreciation expense in Ca Mau 1&2 power plant would decline by VND 280 billion in 2H 2019, directly supporting bottom line of POW.
  - In addition, we also expect that machinery part of Nhon Trach 1 will be fully depreciated from 3Q 2019, increasing earnings of POW.
- **In 2H 2019, we forecast that revenue and NPATMI will reach VND 15,794 billion (+6% YoY) and VND 879 billion (+103% YoY), respectively.**

REE – VALUATION IS STILL ATTRACTIVE

INVESTMENT RATIONALES

- **REE holds a potential power and water portfolio**
  - REE owns a power and water portfolio of high-quality assets, which generates sustainable cash dividend with annual yield of 9% - 10% for the company and contributes up to 61% of REE's total NPAT.
  - In the coming years, many power and water firms still have ample earnings growth potential, as some of them are raising their operating capacities while some others are reducing financial leverage, thus improving net financial income.
- **Office-leasing segment is huge "cash-cow" of the holding**
  - Accounting for over 20% of REE's annual profits, the segment is having a massive expansion plan with 22% CAGR of total leasable area in 2017 – 2022 period, corresponding for 30,000 sqm annually.
  - REE's office business also has a strong sales track record when it takes REE less than a year for a new building to be fully occupied.
- **Stock price is underperforming**
  - REE stock currently is trading at 0.97x forward P/B ratio, which we consider quite "cheap" for its high-quality assets. In fact, utilities segment and office leasing segment, with 2018 earnings yields of 15.6% and 23.8% respectively, are the strongest evidence for our belief that book value of the company is still far below the intrinsic value of REE.

RISK TO OUR CALLS

- Real estate performance in the coming years may take longer time to recover than our expectation, affecting even M&E segment.
- Performance of VSH can be lower than our forecast due to legal issues and performance of Thuong Kon Tum (TKT) project.

BUY 27%

CMP (VND)	**37,550**
Target price (VND)	**46,000**
Cash dividend in 12 months	*1,800*

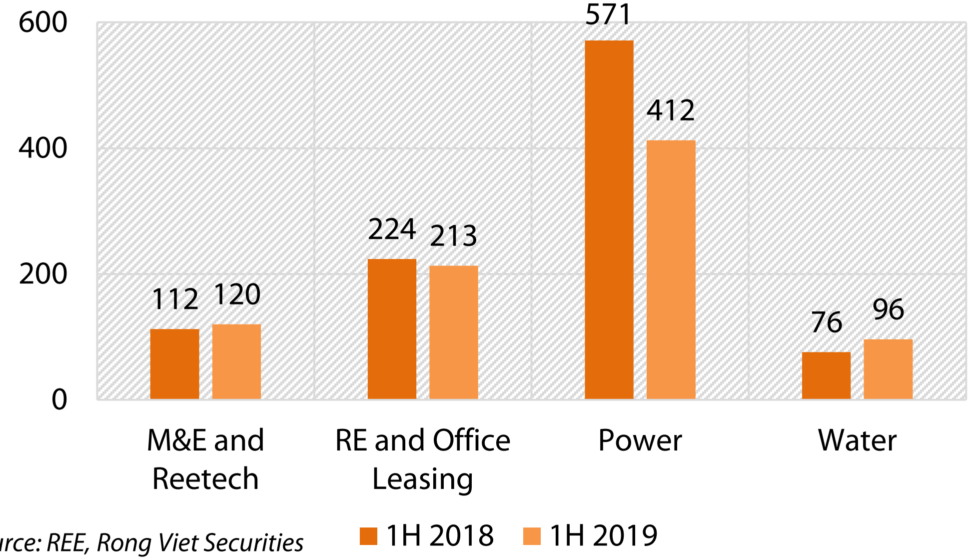
STOCK INFO	
Sector	Industrial Goods & Services
Market Cap ($ mn)	500
Current Shares O/S (mn shares)	310
3M Avg. Volume (K)	740
3M Avg. Trading Value (VND Bn)	24.9
Foreign Ownership (%)	49.0
State Ownership (%)	5.3

FORECAST	2017A	2018A	2019F	2020F
Revenue	4,995	5,101	5,595	5,989
Growth (%)	37	2	10	7
NPATMI	1,377	1,784	1,611	1,917
Growth (%)	26	30	-10	19
ROA (%)	9	9	8	9
ROE (%)	15	17	14	14
EPS (VND)	4,441	5,754	5,191	6,179
Book Value (VND)	25,912	30,055	33,446	37,825
Cash dividend (VND)	1,600	1,800	1,800	1,800
P/E (x)	9.3	5.4	6.3	5.3
P/B (x)	1.5	1.0	0.97	0.86

Weak performance of power segment dragged REE's 1H 2019 earnings down

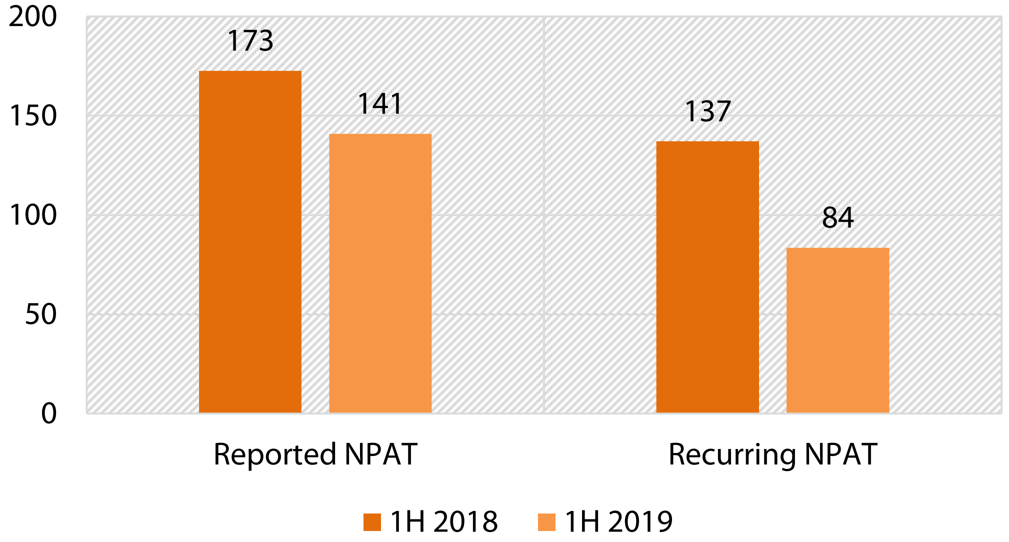
- REE M&E witnessed a slight increase of 7% YoY in 1H 2019 NPAT, an achievement of REE in the context of slow process to get investment licenses for many real estate projects
- Office leasing and real estate segments in 1H 2019 saw a 5% decline in 1H 2019 NPAT as in 1H 2018, REE booked an VND 96 billion one-off profit from disposal of real estate project on No Trang Long street. Excluding these earnings, office leasing and real estate segment increased by 74% YoY in 1H 2019. This strong performance was attributable to office leasing business thanks to Etown Central office building, which has been fully occupied from early 2019.
- Although two above-mentioned segments performed well, power utilities segment of REE was weak results in 1H 2019:
  - o Most hydropower plants had poor performance due to unfavorable hydrological conditions.
  - o Thermal power also witnessed weak results in both core and non-core operating earnings:
    - ➢ Core operating performance of thermal power plants went down due to the decline in sales volume and the rise in coal price in 1H 2019.
    - ➢ One-off income intensified weak core operating earnings of thermal power plants.

Figure 1: Operating earnings of REE's core segments 1H 2019 *(billion VND)*



Source: REE, Rong Viet Securities

Figure 2: Core and Non-core operating earnings of PPC *(billion VND)*



Weak performance of power segment would continue decreasing REE's 2H 2019 NPAT despite the growth in office leasing and water businesses

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- Real estate, office leasing and water businesses is expected to remain positive in 2H 2019. Meanwhile, power segment would be weak in 2H 2019 due to unfavorable hydrological conditions, decreasing 2H 2019 REE's total forecasted NPAT to VND 850 billion.

Table 1 : REE's 2019 forecasted earnings by business segment

VND Billion	2H 2019 earnings	% change YoY	2019 earnings	% change YoY	Comment
M&E and ReeTech	155	18%	275	13%	• In 2H 2018, VND 30 billion provision expense dragged earnings down. • Excluding the impact from the provision, we expect that 2019 NPAT from the segment would remain flat and achieve 2019 guidance of VND 275 billion.
Real Estate & Office Leasing	264	25%	477	13%	• The growth of the segment would be driven by Etown Central and Etown 5, which came into operation in late June 2019 but has been fully occupied.
Power	334	-27%	334	-28%	• Due to unfavorable hydrological conditions
Water	96	23%	192	25%	• Operating capacity Tan Hiep 2 water plant keeps improving, from 85% at the end of 2018 to 100% in mid-2019. • Earnings of water segment would be contributed from Khanh Hoa water plant in 2H 2019
Total	**850**	**-4%**	**1,690**	**-5%**	

Source: Rong Viet Securities forecasts

Progress in M&A activity brighten long term outlook

- Currently, REE is progressing to complete three acquisitions:

Table 2: Acquisitions of REE in the recent time

Acquisition Deal	Comment
Khanh Hoa water plant (KHW)	• REE targets to buy more 5.46 million shares of Khanh Hoa water plant (KHW), increasing its ownership from 24.85% to 45.85%.
Hydropower plant	• Location: The North • Capacity: 34.8 MW • Total equity value: VND 550 billion • REE and TBC, a subsidiary of REE will hold 49% and 51% stake, respectively. • Sales volume: 160 million kWh • Selling price: 1,100 VND/kWh • NPAT: VND 60-70 billion
Wind project	• Location: Soc Trang Province • Capacity: 48 MW • Total capex: VND 2,000 billion. 30% of investment capital will be financed by equity • Sales volume: 180-190 million kWh • Selling price: 9.8 cents/kWh • The project will break ground in October 2019 and come online in late 2020

Source: REE, Rong Viet Securities

=> Therefore, we believe that these acquisitions will enhance intermediate term outlook of the company.

- Besides three above-mentioned deals, the management of REE also shows positive view on disburse capital in the coming periods. Since the company has adjusted its M&A strategy to acquire new power projects to implement on its own, we expect that REE will be able to accelerate disbursement progress. However, with the new M&A method, we believe that cash flow and earnings generated by new projects in the first years may be low, thus putting more challenge for REE to improve its ROE in the intermediate term.

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