October, 2018

Pha Lai Thermal Power JSC (HSX:PPC)

Earnings will remain strong for the next five years

(VND Bn)	Q3-FY18	Q2-FY18	+/-qoq	Q3-FY17	+/-yoy
Net revenue	1,260	2,215	-43%	1,472	-14%
PAT	163	525	-69%	152	8%
EBIT	208	874	-76%	95	118%
EBIT margin	16.5%	39.4%	-2,297bps	6.5%	999bps

Source: PPC, RongViet Securities

3Q 2018 performance: lower contract volume hit core earnings but NPAT still grew due to less provision expenses

Like other thermal power plants, PPC had a relatively lower Qc in the third quarter of 2018 at 920 million kWh (-13% YoY). Heavy rainfall in the North during some periods in 3Q 2018 also brought PPC certain difficulties in boosting sales volume. As a result, 3Q 2018 revenue and recurring NPAT of the company were only VND 1,260 billion (-14% YoY) and VND 156 billion (-16% YoY), respectively.

While less Qc slightly weakened core earnings, non-recurring items played its role to help PPC's reporting a NPAT of VND 163 billion, corresponding to a growth of 8% YoY. The company booked VND 7 billion net FX gains in 3Q 2018, compared to a net loss in 3Q 2017 of VND 34 billion, primarily from provision expenses for its financial investments.

The reversal of financial expenses from FX differences in 2016 is expected to be recognized in 4Q 2018, making it a potential catalyst for PPC's business results

The Ministry of Industry and Trade (MoIT) has made a final decision that, EVN has, this year, to repay the financial expenses from FX differences in 2016 for all power plants including PPC. The repayment process is only expected to be completed in the last quarter of this year. With the reversal amount of up to VND 125 billion, we estimate that 4Q 2018 earnings could increase by 136% YoY to VND 214 billion.

Valuation and Recommendation:

Due to recent changes in capex plans, PPC has significantly reduced uncertainties in its short-term performance, thus eliminating the related risks and enhancing its ability to maintain a stable annual cash dividend of 2,500 VND/share. This dividend level, corresponding to a yield of 14%, is relatively attractive in such a defensive sector.

Regarding 2018 business results, we estimate that NPAT could rise by 28% YoY to VND 1,093 billion due to the large one-off income from the reversal of the expense from FX differences. However, our projection is that earnings in the coming years would remain at high level even without any extraordinary profits.

*Our target price is **VND 23,000 per share**. This target price, coupled with a VND 2,500 cash dividend in the next 12 months, would yield a total return of 44% (calculated based on the closing price on 23 October). Therefore, we have a **BUY** recommendation on PPC.*

BUY +44%

CMP (VND)	17,750
Target price (VND)	23,000
Cash dividend (VND)*	2,500

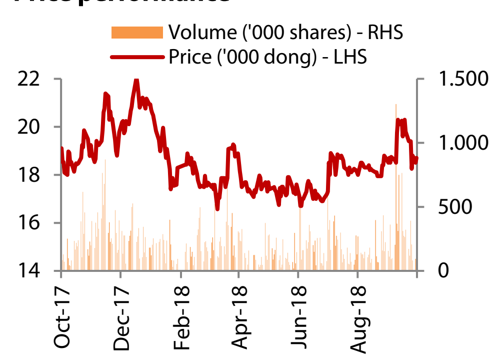
** Expected in the next 12 months*

Stock info

Sector	Utilities
Market Cap (VND billion)	6,136
Current Shares O/S	320,613,054
Avg. Daily Volume (in 20 sessions)	240,368
Free float (%)	19
52 weeks High	22,058
52 weeks Low	16,567
Beta	0.8

	FY2017	Current
EPS	2,680	2,869
EPS growth (%)	29.9	-40.2
Adjusted EPS	2,808	2,626
P/E	8.5	6.5
P/B	1.3	1.0
EV/EBITDA	10.0	6.6
Cash dividend	2,500	2,500
ROE (%)	15.6	16.5

Price performance



Major Shareholders (%)

EVNGENCO2	51.9
REE Corp.	23.4
Samarang Ucits - Samarang Asian Prosperity	9.1
Foreign ownership room (%)	33.7

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Exhibit 1: Q3 2018 results

Particulars (VND B)	Q3-FY18	Q2-FY18	+/-(QoQ)	Q3-FY17	+/-(YoY)	3Q-FY18	+/-(YoY)
Net revenue	1,260	2,215	-43.1%	1,472	-14.4%	5,277	14.0%
Gross profit	170	347	-51.1%	181	-6.2%	783	14.3%
SG&A	-17	-18	-6.1%	-17	2.0%	-54	-4.9%
Operating income	204	642	-68.3%	175	16.1%	1,081	24.0%
EBITDA	216	882	-75.5%	105	106.4%	1,277	56.2%
EBIT	208	874	-76.2%	95	117.7%	1,252	58.5%
Financial expenses	4	230	-98.4%	-83	N/A	167	N/A
- Interest Expenses	-6	-7	-25.2%	-15	-63.1%	-19	-69.9%
Dep. and amortization	8	8	0.5%	9	-10.7%	25	-9.3%
Non-recurring items (*)	7	195	-96.2%	-34	N/A	155	2314.6%
Extraordinary items (*)							
PBT	204	644	-68.3%	178	14.5%	1,085	23.1%
PAT	163	525	-68.9%	152	7.6%	878	17.9%
(*) Adjusted PAT	156	330	-52.8%	185	-16.0%	724	-2.0%

Source: PPC, RongViet Securities

Exhibit 2: Q3 2018 performance analysis

Particulars	Q3-FY18	Q2-FY18	+/-(QoQ)	Q3-FY17	+/-(YoY)
Profitability ratios (%)					
Gross margin	13.5	15.7	-219bps	12.3	117bps
EBITDA margin	17.1	39.8	-2,268bps	7.1	1,002bps
EBIT margin	16.5	39.4	-2,297bps	6.5	999bps
Net margin	12.9	23.7	-1,073bps	10.3	265bps
Adjusted net margin	12.4	14.9	-254bps	12.5	-17bps
Turnover *(x)					
-Inventories	7.9	13.1	-5.2	11.1	-3.2
-Receivables	2.2	3.4	-1.1	2.1	0.1
-Payables	11.0	16.6	-5.6	19.6	-8.6
Leverage (%)					
Total debt/ equity	33.9	38.6	-463bps	41.4	-747bps

Source: PPC, (*) Annualized turnover

Exhibit 3: Q4 2018 performance forecast

Particulars (VND B)	Q4-FY18	+/-(QoQ)	+/-(YoY)
Revenue	1,670	-43%	4%
Gross profit	139	-51%	24%
EBIT	144	-76%	264%
NPAT	214	31%	136%

Source: PPC, RongViet Securities.

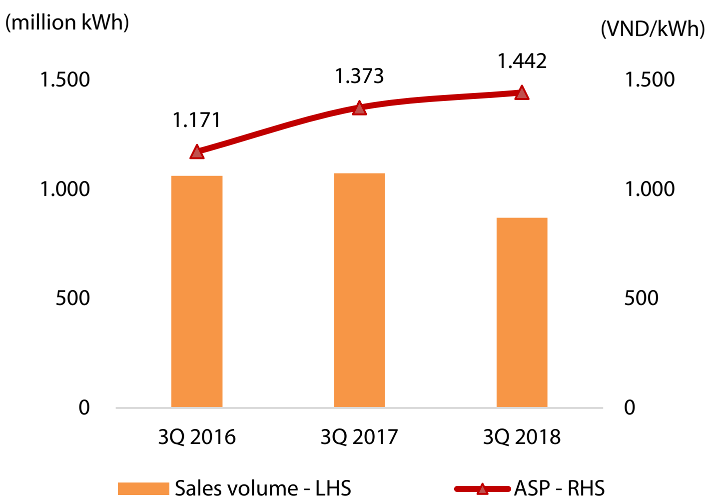
Updates

PPC managed a significant improvement in its average selling price (ASP) while sales volume decreased

Heavy rainfall in the North in 3Q 2018 did bring some challenges for the company. Total sales volume reached 870 million kWh (-19% YoY) amid a reduction in contract volume (-13% YoY). However, favorable momentum in the competitive generation market (CGM) continued in the third quarter, helping PPC achieve a selling average price growth of 5%.

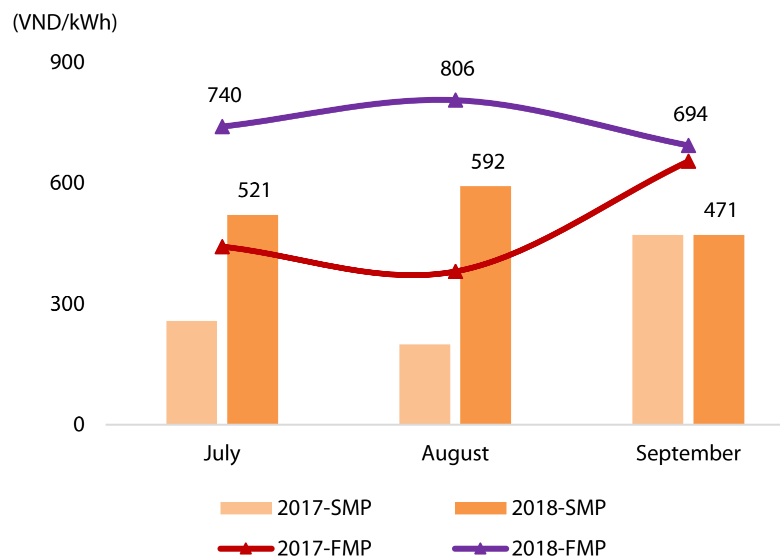
The improvement in ASP resulted in higher gross profit per each kWh output, which then compensated for the impact from the reduction in volume. Therefore, PPC's gross profit this quarter was VND 170 billion (-6% YoY) while revenue declined by 14% YoY to VND 1,260 billion.

Figure 1. Total sales volume and ASP of PPC



Source: PPC, RongViet Securities

Figure 2. Monthly average market price (SMP and FMP) on CGM in the third quarters of 2017 - 2018



Source: PPC, RongViet Securities

**SMP: Spot market price*

FMP: Full market price

Changes in capex plans result in lower risks for PPC

To comply with the National Technical Regulation on Emission of Thermal Power Industry and to improve operation efficiency of the Pha Lai 1 plant, PPC initially plan to install NOx, SOx gas treatment systems. It also wants to upgrade the Pha Lai 1 plant which should cost the company VND 4.6 trillion. Meanwhile, the outcome of both projects in terms of electricity output and PPA prices seems unclear, making it a potential risk for PPC's short-term business results.

However, the gas treatment systems may no longer be required by the government since their benefits are unmeasurable while to total amount EVN has to subsidy them could be huge, about USD 1 billion. Therefore, the company expects to replace these projects by Pha Lai 3, a new 600 MW power plant. Currently, PPC already has the available land bank for the new project and is waiting for a license. Pha Lai 1, the older power plant that need upgrades, will see major repair costs increase from VND 300 billion/ year recently to about VND 350 billion/ year in the near future.

While we consider the prospect of the Pha Lai 3 power project uncertain and too early to factor in PPC's earnings forecast, we still have a positive view on the above-mentioned changes. The cancelation of gas treatment and upgrade projects would reduce cash flow and earnings risks for PPC, thus maintaining the ability to pay a stable cash dividend of 2,500 VND/share, corresponding to a 13% dividend yield at current market price.

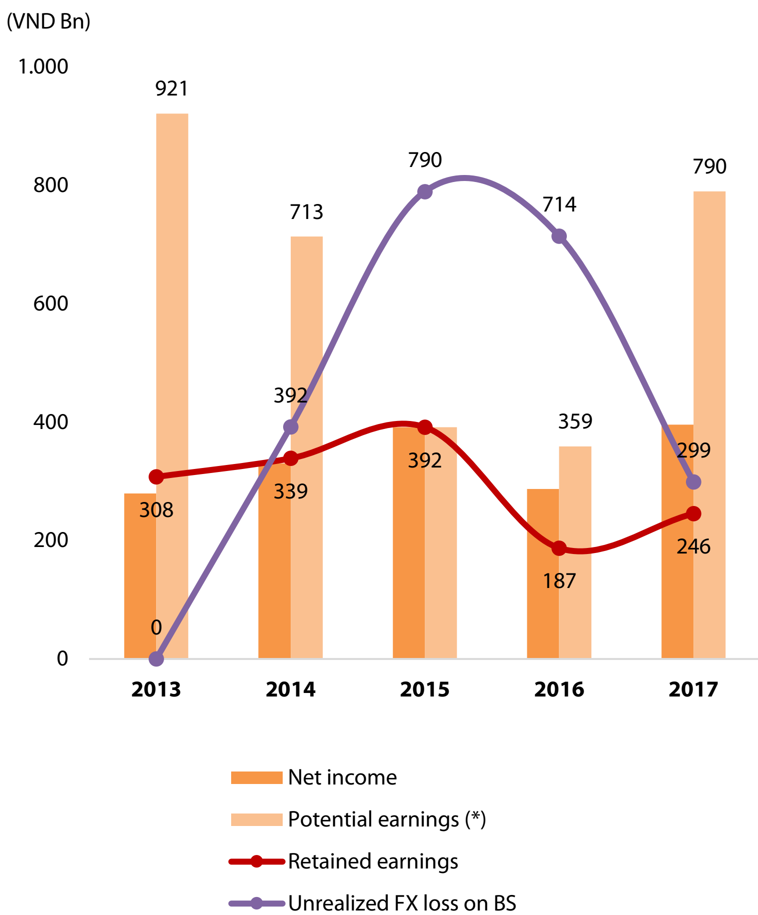
HND and QTP reaching a turning point would improve PPC's outlook

PPC has an ownership in two other thermal power plants including 26% in the Hai Phong thermal power plant (UpCOM:HND) and 16% in the Quang Ninh thermal power plant (UpCOM:QTP). Since PPC only releases financial report of the parent company, earnings from these affiliates will be recognized to PPC once they are paid-out as cash dividend. Over the last three years, HND paid a relatively low cash dividend while QTP paid no dividend due to its negative retained earnings.

According to Decree 82, the amount of unrealized FX loss during the construction of power plants as of December 2015 could be recognized in an account called "Foreign exchange differences". The amount must then be fully amortized into annual earnings by 2019. Until 2017, HND has amortized the majority of the amount and still maintained a stable net income. Therefore, the company was able to pay a cash dividend of 200 – 650 VND/share.

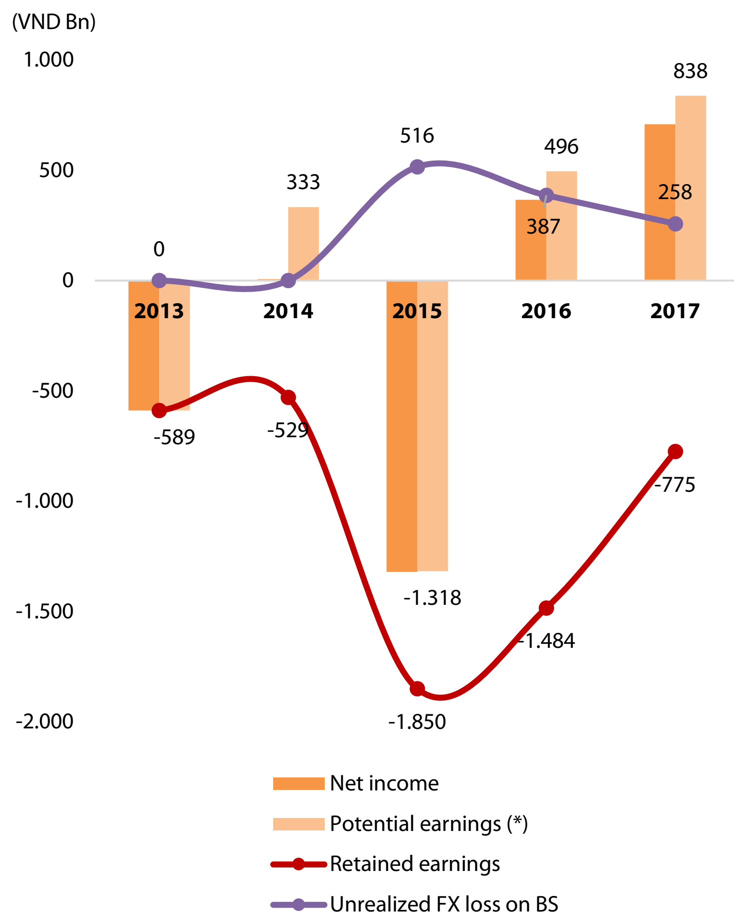
Meanwhile, the situation of QTP is quite different as the company still has a large amount of accumulated losses. Therefore, QTP could not pay a cash dividend even though its earnings in 2016 – 2017 were higher than that of HND.

Figure 3. Unrealized FX loss on balance sheet and its impact on HND



Source: HND, RongViet Securities

Figure 4. Unrealized FX loss on balance sheet and its impact on QTP



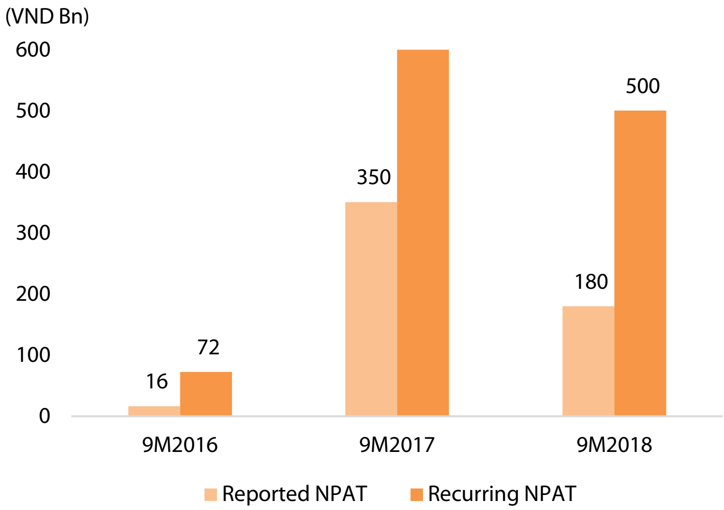
Source: QTP, RongViet Securities

**Potential earnings is the estimated NPAT in case there was no amortization of the "unrealized FX loss on BS" to earnings of each year*

Nevertheless, we believe that both power companies are at a turning point in their performance. Regarding HND, the company has amortized the majority of its unrealized FX loss on its balance sheet, leaving only a small amount of VND299 billion to be attributed in 2018 – 2019; a much smaller amount than the VND 415 billion attribution in 2017. Therefore, we estimate that 2018 NPAT of HND could reach VND 350 billion. That would translate to an EPS of 650 VND/share and may still continue to grow significantly in the next few years. Strong earnings would consequently enhance HND's ability to raise its annual cash dividend.

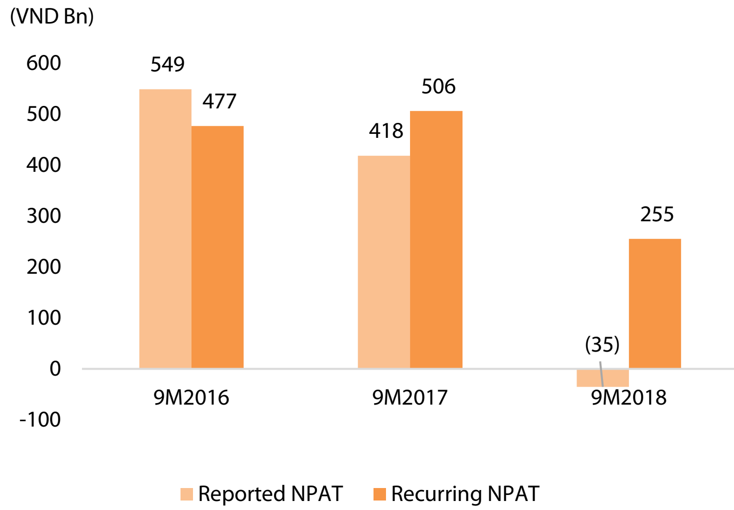
For QTP, the amortization of the FX loss on the balance sheet is expected to remain stable at VND 129 billion per year in 2018 – 2019. However, as the recurring earnings of the company remains strong, we believe that QTP would turn its accumulated loss into positive retained earnings in 2019, thus starting to be able to pay a cash dividend from 2020 onward.

Figure 5. NPAT and recurring NPAT of HND in the first nine months of 2016 - 2018



Source: HND, RongViet Securities

Figure 6. NPAT and recurring NPAT of QTP in the first nine months of 2016 - 2018



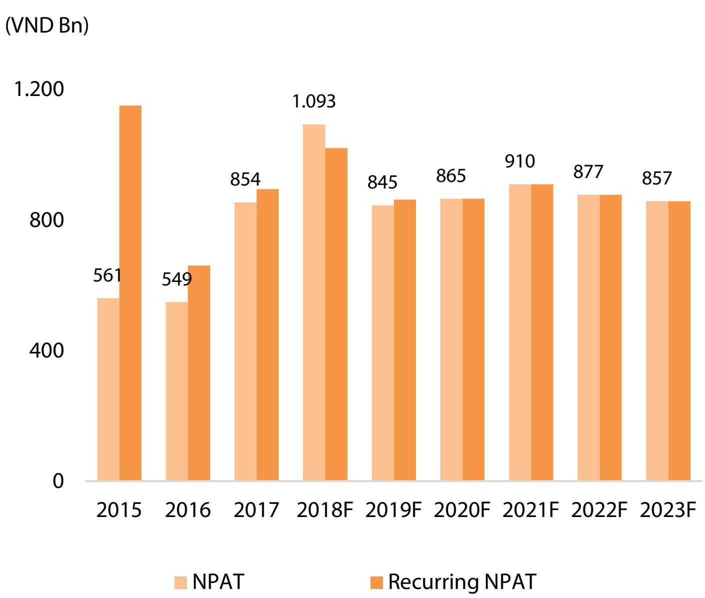
Source: QTP, RongViet Securities

Overall, 2018 – 2019 could be the turning point in both business performances and financial conditions for HND and QTP. For this reason, we expect that their cash dividend policy would see a significant improvement in the coming years and become the new catalysts for earnings growth. Therefore, we also believe that the market would eventually reevaluate PPC to reflect the contribution of its investments in HND and QTP.

Strong level of earnings and cash flows equals high stable dividend for PPC

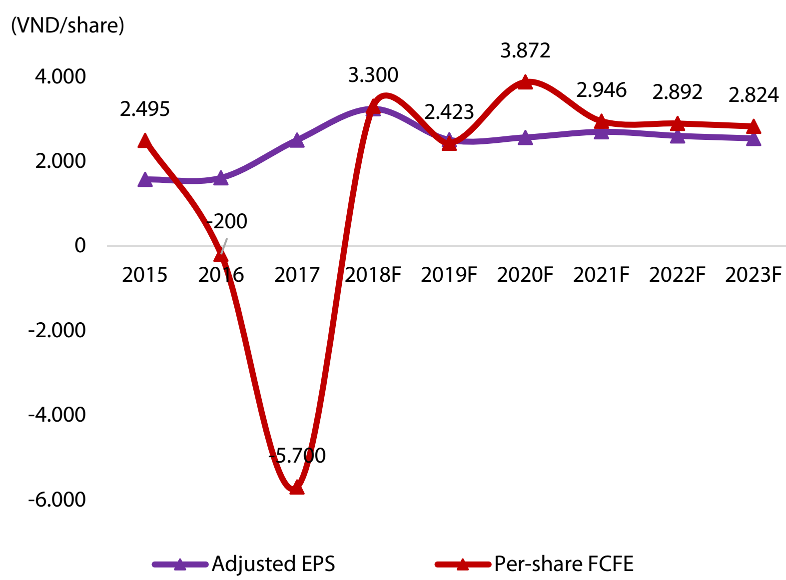
Our projection is that EPS in 2018 for PPC would be 3,317 VND/share while EPS in 2019 – 2023 would be stable at about 2,700 VND/share. In addition, as the company is collecting its receivable on loans given to EVN, the actual per-share FCFE in 2018 – 2020 would be slightly higher than EPS, thus enabling PPC to maintain its current cash dividend level of 2,500 VND/share, corresponding to a 14% dividend yield.

Figure 7. PPC's NPAT compared to its recurring NPAT



Source: PPC, RongViet Securities

Figure 8. PPC's per-share FCFE compared to its per-share earnings



Source: PPC, RongViet Securities

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VND in billions

Income statement	FY2016	FY2017	FY2018E	FY2019F
Revenue	5,977	6,236	6,930	7,089
COGS	5,474	5,445	5,934	6,183
Gross profit	**504**	**791**	**996**	**907**
Selling expense	0	0	0	0
G&A expense	108	81	102	106
Finance income	411	412	407	289
Finance expense	254	120	-65	33
Other profits	-2	1	0	0
Gain/(loss) from JVs	64	0	0	0
PBT	**616**	**1,003**	**1,366**	**1,057**
Prov. of tax	62	149	273	211
Minority's interest	-6	0	0	0
PAT to equity S/H	**560**	**854**	**1,093**	**845**
EBIT	396	710	894	800

%

Financial ratio	FY2015	FY2016	FY2017E	FY2018F
Growth (%)				
Revenue	-22.0	4.3	11.1	2.3
Operating income	-54.0	79.5	25.9	-10.5
EBITDA	-64.5	59.7	24.2	-10.1
PAT	-2.2	55.7	28.0	-22.6
Total assets	-4.4	-28.7	-2.7	-6.2
Equity	-9.5	6.2	4.3	0.0
Profitability (%)				
Gross margin	8.4	12.7	14.4	12.8
EBITDA margin	6.6	11.4	12.9	11.3
EBIT margin	7.8	12.0	13.4	11.8
Net margin	9.2	13.7	15.8	11.9
ROA	5.2	11.3	14.9	12.3
ROE	10.6	15.6	19.1	14.8
Efficiency (x)				
Receivable turnover	0.4	0.4	0.3	0.3
Inventory turnover	0.1	0.1	0.1	0.1
Payable turnover	0.2	0.2	0.2	0.2
Liquidity (x)				
Current	4.1	2.4	2.6	3.2
Solvency (%)				
Total debt/equity	0.8	0.2	0.1	0.1
Current debt/equity	0.1	0.1	0.1	0.1
Long-term Debt/equity	0.7	0.1	0.0	0.0

VND in billions

Balance sheet	FY2016	FY2017	FY2018E	FY2019F
Cash and cash equivalents	786	209	456	409
Short-term investments	2,110	550	550	550
Accounts receivable	2,727	2,260	2,387	2,020
Inventories	557	552	623	649
Other current assets	5	16	16	16
Property, plant & equipment	741	687	654	620
Acquired intangible assets	0	0	0	0
Long-term investments	1950	2269	2402	2402
Other non-current assets	1711	1006	257	222
Total assets	**10,588**	**7,548**	**7,344**	**6,889**
Accounts payable	1,114	1,076	1,074	1,119
Short-term borrowings	382	444	507	0
Long-term borrowings	3,825	507	0	0
Other non-current liabilities	0	0	0	0
Bonus and welfare fund	73	45	51	55
Technology-science, dev. fund	0	0	0	0
Total liabilities	**5,394**	**2,072**	**1,631**	**1,174**
Common stock and APIC	3,262	3,274	3,274	3,274
Treasury stock (enter as -)	-126	-87	-87	-87
Retained earnings	1,496	1,579	1,729	1,717
Other comprehensive income	-25	171	171	171
Inv. and dev. fund	548	540	627	640
Total equity	**5,155**	**5,477**	**5,713**	**5,715**
Minority interest	**38**	**0**	**0**	**0**

Valuation ratio	FY2016	FY2017	FY2018E	FY2019E
EPS (VND)	2,063	2,680	3,238	2,505
P/E (x)	8.1	8.5	7.6	7.3
BV (VND)	17,083	17,821	17,794	17,889
P/B (x)	1.0	1.3	1.0	1.0
DPS (VND/cp)	2,000	2,500	2,500	2,500
Dividend yield (%)	12.0	11.0	13.4	13.4

Valuation model	*Price*	*Weight*	*Average*
FCFF	23,376	30%	7,013
PE	22,430	40%	8,972
EV/EBITDA	23,313	30%	6,994
Target price (VND)			**23,000**

Valuation history	*Price*	*Recommendation*	*Period*
15/03/2017	19,400	Accumulate	Long term
20/09/2016	19,400	Accumulate	Long term
15/05/2016	19,100	Neutral	Long term

RESULTS 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 that 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	BUY	ACCUMULATE	REDUCE	SELL
Total Return including Dividends in 12-month horizon	>20%	5% to 20%	-20% to -5%	<-20%

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