September, 2018

Da Nang Rubber JSC (DRC - HSX)

Difficult to reach a turning point

Particulars (VND B)	Q2-FY18	Q1-FY18	+/- QoQ	Q2-FY17	+/- YoY
Net revenue	927.6	733.6	26.4%	863.6	7.4%
PAT	54.4	20.7	162.2%	34.7	56.7%
EBIT	81.5	35.5	129.8%	55.0	48.2%
EBIT margin	8.8%	4.8%	395.2 bps	6.4%	241.8 bps

Source: DRC, Rong Viet Securities

2Q 2018 performance: Profit improvement from a low base in 2Q 2017

In 2Q 2018, revenue reached VND 927.6 billion (+7.4% yoy) mainly due to the growth in revenue of two key products including bias tires and radial tires. 2Q 2018 revenue of bias tire segment saw an increase of 9% compared to 2Q 2017. This result was primarily driven by a jump in sales of heavy bias truck tire, which accounts for 50% of bias tire segment's revenue, from a low base of 2Q 2017. Revenue of radial tire segment in 2Q 2018 reached VND 349 billion (+2% yoy) due to 2.8% yoy increase in selling price, while sales volume stayed stable as the same period last year. Thanks to the improvement in revenue of the two key segments, gross profit in 2Q 2018 reached VND 132 billion (+18% yoy), resulting in 56.7% yoy growth in NPAT.

3Q 2018 Outlook: Expect no significant breakthroughs

Regarding bias tires, Euro 4 standard remains to be a tough challenge for OEM bias tires in 3Q 2018. Although DRC has worked on a plan to upgrade OEM bias tire assembly line to light truck radial (LTR) tire one in late-June, we expect that DRC could get the LTR tire sales contracts with Thaco and TMT in 4Q at the earliest. Therefore, similar to 1H 2018, revenue of bias tire in 3Q continues to lose the contribution of OEM bias tires, which accounts for up to 25% of bias tire revenue. In addition, although the phase 2 of radial factory came online since early-July, a surge in sales of radial tire segment would not happen in 3Q 2018, considering unchanged business conditions of the company. We forecast that the utilization rate of total radial factory will be 64% in 3Q 2018, corresponding to 96,000 tires per quarter (+20% yoy). Therefore, we estimate that 3Q 2018 revenue and NPAT would reach VND 950 billion (+8.2% yoy) and VND 40.7 billion (+60.8% yoy), respectively.

Valuation and Recommendation: *Regarding 2018 outlook, we estimate that 2018 NPAT would increase by 7.1% YoY to VND 178 billion, corresponding to EPS of 1,381 VND/share. Regarding the divestment of Vinachem, we expect that if the potential buyer is a car manufacturer, this event could become a positive driver for market sentiment and support stock price in the short term.*

We evaluate DRC price at VND ***24,300/share*** *and forecast a cash dividend of VND 1,000 per share in the following 12 months, which results in a* ***-2%*** *total return from the closing price on September 5th, 2018. We rate* ***REDUCE*** *for DRC.*

REDUCE -2%

CMP (VND)	25,900
Target Price (VND)	24,300
Cash Dividend (VND)*	1,000

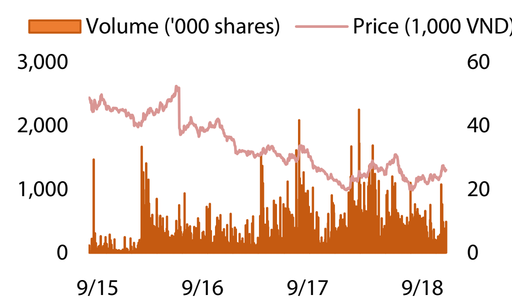
** Expected in the next 12 months*

Stock Info

Sector	Automobile & Parts
Market Cap (VND B)	3,053
Current Shares O/S	118,792,605
Beta	0.68
Free Float (%)	39
52-week High	29,800
52-week Low	18,700
Avg. Daily Volume (20 sessions)	282.9

	FY2017	Current
EPS	1,297	1,018
EPS Growth (%)	-57.6	-56.4
Adjusted EPS	1,297	1,018
P/E	18.6	26.37
P/B	1.9	4.3
EV/EBITDA	7.2	8.5
Cash Dividend	1,300	1,000
ROE (%)	10.7	8.8

Price performance



Major Shareholders (%)

Vinachem	50.51
Remaining foreign room (%)	24.95

Vy Nguyen
(084) 028- 6299 2006 – Ext 1528
vy.ntk@vdsc.com.vn

Son Phan
(084) 028- 6299 2006 – Ext 1519
son.pnt@vdsc.com.vn

Exhibit 1: 2Q 2018 Results

Particulars (VND B)	Q2-FY18	Q1-FY18	+/- (QoQ)	Q2-FY17	+/- (YoY)	H1-FY18	+/-(YoY)
Net revenue	927.6	733.6	26.4%	863.6	7.4%	1,661.2	-5.8%
Gross profit	132.5	76.2	73.7%	111.9	18.4%	208.7	-14.5%
SG&A	41.5	36.0	15.4%	49.9	-16.7%	77.5	-1.9%
Operating income	90.9	40.3	125.9%	62.0	46.6%	131.2	-27.2%
EBITDA	365.8	101.5	260.4%	198.5	84.3%	467.3	27.3%
EBIT	81.5	35.5	129.8%	55.0	48.2%	117.0	-24.0%
Financial expenses	23.4	16.1	45.6%	20.2	16.0%	39.5	3.0%
- Interest Expenses	13.3	9.5	39.3%	11.6	14.4%	22.8	2.7%
Dep. and amortization	284.3	66.0	330.5%	143.5	98.1%	350.3	64.3%
Non-recurring items (*)							
Extraordinary items (*)							
PBT	68.3	26.0	162.9%	43.4	57.2%	94.2	-28.7%
PAT	54.4	20.7	162.2%	34.7	56.7%	75.1	-28.5%
(*) Adjusted PAT	54.4	20.7	162.2%	34.7	56.7%	75.1	

Source: DRC, Rong Viet Securities

Exhibit 2: 2Q 2018 Performance Analysis

Particulars	Q2-FY18	Q1-FY18	+/- (QoQ)	Q2-FY17	+/- (YoY)
Profitability Ratios (%)					
Gross Margin	14.3	10.4	388.6 bps	13.0	132.2 bps
EBITDA Margin	8.8	13.8	-504.9 bps	23.0	-1419.6 bps
EBIT Margin	8.8	4.8	395.2 bps	6.4	241.8 bps
Net Margin	5.9	2.8	303.3 bps	4.0	184.4 bps
Adjusted Net Margin	5.9	2.8	303.3 bps	4.0	184.4 bps
Turnover *(x)					
-Inventories	3.8	3.7	0.1	3.2	0.6
-Receivables	11.9	8.8	3.1	8.6	3.3
-Payables	8.2	7.8	0.3	8.8	(0.6)
Leverage (%)					
Total Debt/ Equity	80	65	1551.0 bps	82	-197.4 bps

Source: DRC, (*) Annualized turnover

Exhibit 3: 3Q 2018 Performance Forecast

Particulars (VND Billion)	Q3-2018	+/- (QoQ)	+/- (YoY)
Revenue	949.7	2.4%	8.2%
Gross profit	121.1	-8.6%	23.3%
EBIT	64.2	-21.2%	54.2%
NPAT	40.7	-25.1%	60.9%

Source: DRC, Rong Viet Securities

Updates

Although phase 2 of radial factory came online since early – July 2018, a surge in sales is not likely to happen in 3Q 2018.

Early in 3Q 2018, the phase 2 of radial factory came into operation, doubling designed capacity of whole factory to 600,000 tires per year. Over the first six months of 2018, sales volume of radial tires reached around 28,000 – 30,000 units per month, corresponding to revenue of VND 619 billion in the first half of 2018 (+1.3% yoy). In this period, 68% of radial sales was from exporting, around 110,081 units, equivalent to the same period last year. This results in export revenue of USD 17.1 million. In addition, 2Q 2018 is still the most positive quarter over the recent periods because for the first time since 1Q 2016, DRC has achieved a positive gross profit margin (about 4.6%).

We believe that there will be no dramatic increase in sales volume in 2H2018, considering that the company's business conditions would remain unchanged. We expect the company could sell 32,000-35,000 tires/month (around 64% of the factory's capacity) during this time.

The negative impact of application of Euro 4 standard could not be solved in the short term.

According to Decision 49/2011/QD-TTg, from January 1, 2018, importers and manufacturers were required to start selling cars complying with Euro 4-compliant diesel-fuel, instead of Euro 2 emission standard. Meanwhile, bias tires of DRC have just met requirement of Euro 2 emission standard. Therefore, the company faced difficulties in selling OEM bias tires and sold almost no OEM bias tires in the first half of 2018, corresponding to a decrease of VND 170 billion in the bias tire revenue.

DRC has worked on a plan to upgrade OEM bias tire assembly line to light truck radial (LTR) tire one in late-June. Its current designed capacity is 30,000 LTR tires/year, which equals one sixth of annual OEM bias tires' sales volume. Therefore, it is difficult for LTR product to compensate for the sales reduction in OEM bias tires. Thus, we believe that LTR tires' profit would be minor and would not contribute a significant proportion to income of the company, at least until 2020, even when DRC signs sale agreements with Thaco and TMT in 4Q 2018.

Concern about DRC's export markets in the future.

Global tire market is projected to experience an increase of 8.4% over the next five years, which inspires DRC to boost export market. To avoid fierce competition with Chinese tire manufacturers, DRC mainly focuses on nations where they impose anti-dumping duty on Chinese tires. Among DRC's export markets, Brazilian and European markets are two main markets that the company aims at. However, we are concerned that export of the company would encounter difficulties in the future.

Currently, Brazil is the largest DRC's export market, which accounts for 50% of its export revenue. However, when anti-dumping duty of this country levying on Chinese tires is overdue in 2019, the company could face risk declining exporting sales volume of Brazilian market due to fierce competition with Chinese tires. Fortunately, the anti-dumping duty was imposed on Chinese tires by European Commission in May 2018, thus DRC intends to take advantage of this opportunity to penetrate European market. Nevertheless, even if the company entered this market, such penetration could not insure that incremental revenue from European market could compensate for potential reduction in revenue from Brazilian tire market.

State divestment from DRC may support stock price in the short term

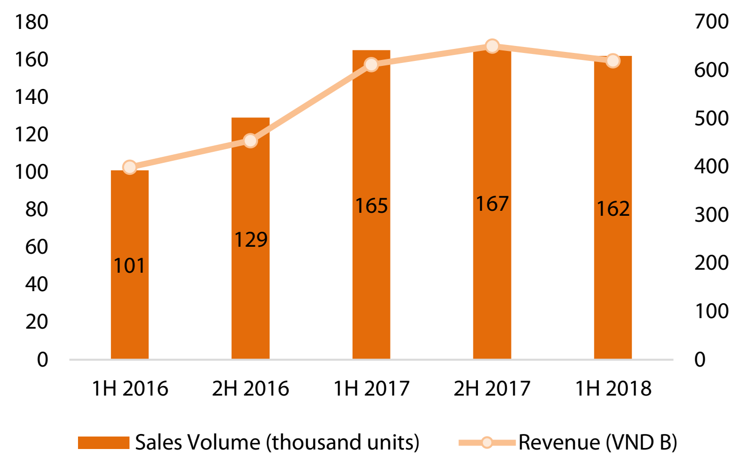
At the end of this year, Vinachem will reduce its stake in DRC to 36% from 50.5%. The news on the divestment of Vinachem might be an element supporting DRC's stock price recently. However, we have yet seen any clear signs of a significant improvement in the DRC's outlook. Therefore, we find the current market valuation for DRC stock quite fair compared to its outlook. If the story of state divestment continues to drive further upward movements in the stock price in the short term, we would consider it an ideal opportunity for investors to diminish their holding in DRC.

Valuation and Recommendation

Regarding 2018 outlook, we estimate that 2018 NPAT would increase by 7.1% YoY to VND 178 billion, corresponding to EPS of 1,381 VND/share. We evaluate DRC price at VND ***24,300/share*** *and forecast a cash dividend of VND 1,000 per share in the following 12 months, which results in a* ***-2%*** *total return from the closing price on September 5th, 2018. We rate* ***REDUCE*** *for DRC.*

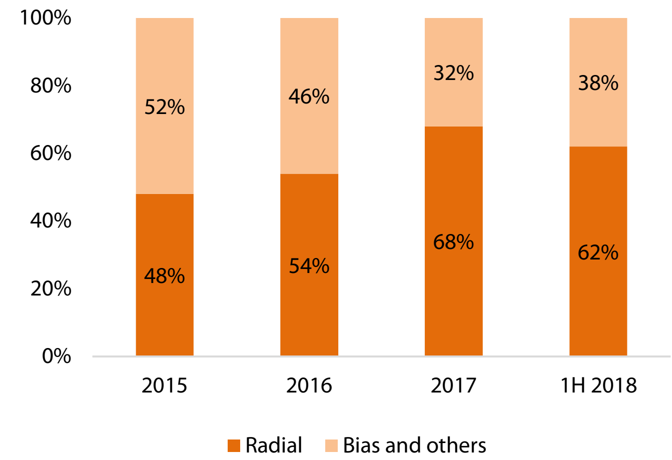
Regarding the divestment of Vinachem, we expect that if the potential buyer is a car manufacturer, this event could become a positive driver for market sentiment and support stock price in the short term.

Figure 1: Revenue and sales volume of DRC's radial tires



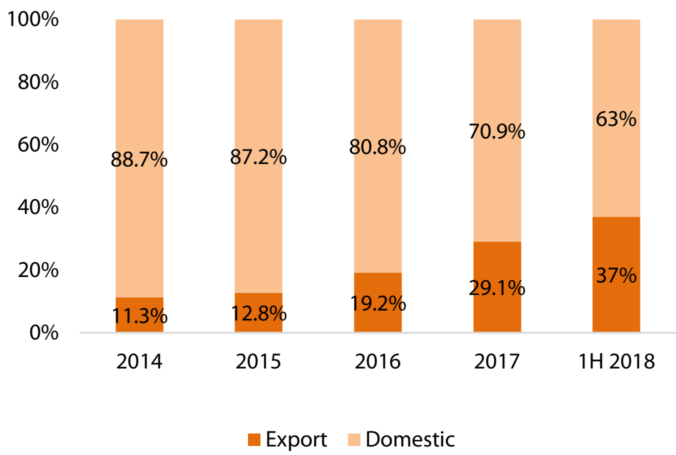
Source: DRC, RongViet Securities

Figure 2: DRC's exporting revenue structure by product



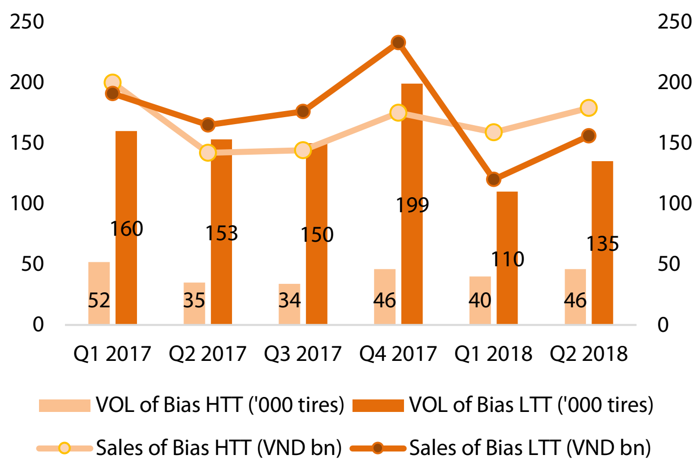
Source: DRC, RongViet Securities

Figure 3: Revenue by markets



Source: DRC, RongViet Securities

Figure 4: Revenue and volume of DRC's bias HTT and LTT



Source: DRC, RongViet Securities

VND Billion

INCOME STATEMENT	FY2016	FY2017	FY2018E	FY2019F
Revenue	3,361	3,669	3,662	3,870
COGS	2,660	3,212	3,193	3,390
Gross profit	701	458	469	480
Selling Expense	85	118	117	124
G&A Expense	73	66	66	70
Finance Income	16	8	10	14
Finance Expense	83	74	81	88
Other profits	18	0	8	8
PBT	494	208	222	220
Prov. of Tax	99	42	44	44
Minority's Interest	0	0	0	0
PAT to Equity S/H	395	166	178	176
EBIT	543	273	286	287
EBITDA	775	522	549	577

%

FINANCIAL	FY2016	FY2017	FY2018E	FY2019F
Growth (%)				
Revenue	1.3	9.2	-0.2	5.7
Operating Income	-15.1	-49.7	4.8	0.3
EBITDA	-8.6	-32.7	5.2	5.1
PAT	-5.0	-58.0	7.1	-1.2
Total Assets	-10.4	-0.7	8.3	-3.4
Equity	-5.4	-3.5	3.0	2.8
Profitability (%)				
Gross margin	20.9	12.5	12.8	12.4
EBITDA margin	23.1	14.2	15.0	14.9
EBIT margin	16.1	7.4	7.8	7.4
Net margin	11.8	4.5	4.9	4.5
ROA	14.0	5.9	5.9	6.0
ROE	25.0	10.9	11.3	10.9
Efficiency (x)				
Receivables Turnover	8.0	8.9	8.5	9.3
Inventories Turnover	3.5	5.4	4.3	4.2
Payables Turnover	8.5	10.4	9.0	8.7
Liquidity				
Current	1.5	1.3	1.4	1.7
Solvency (%)				
Total Debt/Equity	57.2	61.2	68.4	55.4
Current Debt/Equity	32.5	34.4	35.3	26.3
Long-term Debt/Equity	24.8	26.8	33.1	29.1

VND Billion

BALANCE SHEET	FY2016	FY2017	FY2018E	FY2019F
Cash and cash equivalents	51	67	61	125
Short-term investments	0	0	0	0
Accounts receivable	419	412	430	418
Inventories	771	596	735	806
Other current assets	6	15	15	19
Property, plant & equipment	1,499	1,635	1,712	1,473
Acquired intangible assets	6	15	15	14
Long-term investments	4	4	4	4
Other non-current assets	59	50	53	63
Total assets	**2,815**	**2,794**	**3,025**	**2,922**
Accounts payable	312	310	355	388
Short-term borrowings	513	525	555	425
Long-term borrowings	392	409	520	470
Other non-current liabilities	0	0	0	0
Bonus and Welfare fund	16	23	23	23
Technology-science, dev. fund	0	0	0	0
Total liabilities	**1,233**	**1,268**	**1,453**	**1,307**
Common stock and APIC	1,188	1,188	1,188	1,188
Treasury stock (enter as -)	0	0	0	0
Retained earnings	225	142	181	218
Other comprehensive income	21	21	21	21
Inv. and Dev. Fund	149	176	182	188
Total equity	**1,582**	**1,527**	**1,572**	**1,615**
Minority Interest	**0**	**0**	**0**	**0**

VALUATION RATIO	FY2016	FY2017	FY2018E	FY2019F
EPS (dong)	3,059	1,297	1,381	1,365
P/E (x)	9.6	17.3	19.1	19.3
BV (dong)	13,318	12,854	13,234	13,598
P/B (x)	2.4	1.9	2.0	1.9
DPS (dong/cp)	2,800	1,300	1,000	-
Dividend yield (%)	8.7	5.4	3.9	0.0

VALUATION MODEL	Price	Weight	Average
FCFE	25,552	50%	12,775
PE	23,020	50%	11,510
Target price (dong)			**24,286**

VALUATION HISTORY	Price	Recommendation	Period
14/07/2017	33,100	Buy	Long term
26/12/2017	28,200	Neutral	1-year

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 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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ANALYSIS & INVESTMENT ADVISORY DEPARTMENT

Bernard Lapointe
Head of Research
bernard.lapointe@vdsc.com.vn
+ 84 28 62992006 (1525)

Lam Nguyen
Senior Strategist
lam.ntp@vdsc.com.vn
+ 84 28 6299 2006 (1313)
- Banking
- Market Strategy

Hieu Nguyen
Senior Analyst
hieu.nd@vdsc.com.vn
+ 84 28 6299 2006 (1514)
- Market Strategy
- Pharmaceuticals
- Aviation

Duong Lai
Senior Analyst
duong.ld@vdsc.com.vn
+ 84 28 6299 2006 (1522)
- Real Estate
- Building Materials

Vu Tran
Senior Analyst
vu.thx@vdsc.com.vn
+ 84 28 6299 2006 (1518)
- Oil & Gas
- Fertilizer

Trinh Nguyen
Senior Analyst
trinh.nh@vdsc.com.vn
+ 84 28 6299 2006 (1331)
- Steel
- Construction
- Technology

Son Phan
Analyst
son.pnt@vdsc.com.vn
+ 84 28 6299 2006 (1519)
- Utilities
- Natural Rubber

Tu Vu
Analyst
tu.va@vdsc.com.vn
+ 84 28 6299 2006 (1511)
- Macroeconomics

Son Tran
Analyst
son.tt@vdsc.com.vn
+ 84 28 6299 2006 (1527)
- Market Strategy
- Retails
- Consumer chemicals

Tung Do
Analyst
tung.dt@vdsc.com.vn
+ 84 28 6299 2006 (1521)
- Logistics
- Aviation

Thu Pham
Analyst
thu.pa@vdsc.com.vn
+ 84 28 6299 2006 (1520)
- Industrial Real Estate

Thao Dang
Analyst
thao.dtp@vdsc.com.vn
+ 84 28 6299 2006 (1529)
- Food & Beverage
- Textiles

Tam Pham
Analyst
tam.ptt@vdsc.com.vn
+ 84 28 6299 2006 (1530)
- Insurance

Anh Nguyen
Analyst
anh2.ntt@vdsc.com.vn
+ 84 28 6299 2006 (1531)
- Banking

Vy Nguyen
Analyst
vy.ntk@vdsc.com.vn
+ 84 28 6299 2006 (1528)
- Automobile & Parts

Trinh Le
Analyst
trinh.lx@vdsc.com.vn
+ 84 28 6299 2006 (1536)
- Industrials

Ha Tran
Assistant
ha.ttn@vdsc.com.vn
+ 84 28 6299 2006 (1526)

Vi Truong
Assistant
vi.ttt@vdsc.com.vn
+ 84 28 6299 2006 (1517)

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