PHA LAI THERMAL POWER PLANT JSC (HSX: PPC)

Higher Qc and declining profitability do not guarantee growth

(VND bn)	Q4-FY19	Q3-FY19	+/-qoq	Q4-FY18	+/-yoy
Net revenue	2,274	1,958	16%	1,840	24%
PAT	491	193	155%	277	77%
EBIT	576	282	104%	312	85%
EBIT margin	25.3%	14.4%	1,093bps	16.9%	838bps

Source: PPC, Rong Viet Securities

FY2019 – Continued to benefit from unfavorable hydrology and lowered maintenance expenses

- PPC achieved a 8.2% increase in electricity output, driven by a 55% growth in Qm (market quantity). Revenue and NPAT growth rates came at 15.0% YoY and 12.9% YoY.
- PPC's 2019 gross margin stabilized at 15.7% compared to 2018's 16.1% despite the local coal shortage. It managed to stabilize its coal price throughout the year. We believe it was also because of the exchange rate fluctuation revenue and the actual maintenance expenses being less than registered at the beginning of 2019.
- PPC paid off Yen debts and has gradually become nearly debt-free.

FY2020 outlook – Unclear growth potential because a higher Qc (contract quantity) may cause opposing effects on business results

On the one hand, we think a high 2020 Qc for Pha Lai 1 plant (1.7 billion kWh, +15.1% yoy) will benefit the company due to its inferior efficiency. On the other hand, the fact that Pha Lai 2 plant Qc could increase by 10.2% for 2020 leaves less room for profit-optimizing opportunities on the CGM.

PPC's gross margin is forecasted to decline in 2020, as the coal change is likely to impact PPC to a greater extent. We predict that its gross margin will be reduced to 12.8%.

Our 2020 forecast includes VND 9,138 billion (~USD 393.9 Mn, +11.7% yoy) in revenue and VND 1,103 billion (~USD 47.5 Mn, -13.0% yoy) in NPAT, higher than the previous update due to re-estimating the coal price impact and financial activities.

Valuation and recommendation

*Even though PPC has improved its financials and offered annual cash dividends, we believe the potential has been fully reflected in its market price. We think that 2019 was the peak in PPC's earnings as there will be less opportunities for the company to generate profit this year. PPC is going to face a coal shortage which will impact profitability. A lower PPA price for Pha Lai 1 plant and a more difficult CGM are the risks to PPC's growth potential in the intermediate term. The share price performance during the latter part of 2019 resulted in overpriced valuations at the beginning of 2020. We adjusted P/E and EV/EBITDA multiples downward to reflect the rising risks in the stock market recently. Consequently, the FCFE, P/E and EV/EBITDA methods put PPC's value at **VND22,500** (revised down 4% from our TP in 2020 strategy report), implying that the current market price is around the "fair" level as the total expected return is **8%** at the closing price on March 13th 2020. Therefore, we rate this stock as **NEUTRAL**.*

NEUTRAL +8%

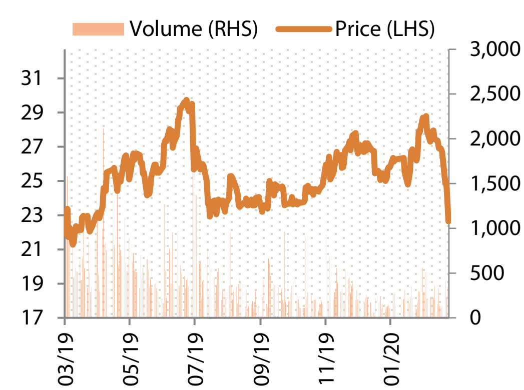
Target price (VND)	22,500
Current market price (VND)	22,800
Cash dividend in 12 months	*2,200*

Stock Info

Sector	Utilities
Market Cap (USD million)	314.3
Current Shares O/S (Mn shares)	320.6
3M Avg. Volume (K)	320.5
3M Avg. Trading Value (USD thousand)	258.6
52-week Range (VND thousand)	16.0-29.8

	FY2018	FY2019
EPS	3,501	3,792
EPS Growth (%)	30.6	8.3
Diluted EPS	3,501	3,792
P/E	8.5	8.4
P/B	1.3	1.5
EV/EBITDA	6.4	7.0
Cash dividend yield (%)	13.8	10.0
ROE (%)	19.9	21.2

Price performance



Major Shareholders (%)

GENCO 2	51.9
REE	24.1
Samarang Ucits	9.1
Foreign ownership room (%)	32.6

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Exhibit 1: Q4/2019 Results

(VND Bn)	Q4-FY19	Q3-FY19	+/- (qoq)	Q4-FY18	+/- (yoy)
Net revenue	2,274	1,958	16.1%	1,840	23.6%
Gross profit	514	175	193.1%	398	29.1%
SG&A	-26	-9	178.1%	-28	-6.6%
Operating income	540	185	192.3%	426	26.8%
EBITDA	585	291	101.4%	321	82.3%
EBIT	576	282	104.4%	312	84.8%
Financial expenses	15	-41	-136.0%	52	-71.7%
- Interest Expenses	2	3	-33.4%	5	-63.5%
Dep. and amortization	10	9	7.4%	9	2.1%
Non-recurring items (*)					
Extraordinary items (*)					
PBT	591	241	145.2%	364	62.4%
PAT	491	193	155.1%	277	77.4%
(*) Adjusted PAT	491	193	155.1%	277	77.4%

Source: PPC, Rong Viet Securities

Exhibit 2: Q4/2019 Performance Analysis

Particulars	Q4-FY19	Q3-FY19	+/-(QoQ)	Q4-FY18	+/-(YoY)
Profitability Ratios (%)					
Gross Margin	22.6	9.0	1,365bps	21.6	97bps
EBITDA Margin	25.7	14.8	1,090bps	17.5	829bps
EBIT Margin	25.3	14.4	1,093bps	16.9	838bps
Net Margin	21.6	9.8	1,176bps	15.0	655bps
Adjusted Net Margin	21.6	9.8	1,176bps	15.0	655bps
Turnover *(x)					
-Inventories	11.3	13.7	-2.4	14.8	-3.5
-Receivables	4.3	3.5	0.8	3.5	0.8
-Payables	14.6	25.1	-10.5	11.1	3.5
Leverage (%)					
Total Debt/ Equity	21.50	20.7	77bps	22.7	-123bps

Source: Rong Viet Securities

Exhibit 3: Q1/2020 Performance Forecast

Particulars (VND Bn)	Q1-FY20	+/-(QoQ)	+/-(YoY)
Revenue	2,206	-3%	20%
Gross profit	348	-32%	-13%
EBIT	332	-42%	7%
NPAT	274	-44%	-1%

Source: Rong Viet Securities

Update

Output grew steadily but CGM is not as profitable a business as before

Noticeably, PPC's performance improved remarkably in Q4/2019. Firstly, its output exceeded 1.5 billion kWh, +13.7% QoQ and +15.0% YoY because of the hydrology. Secondly, its average coal price remained stable amid a local coal shortage. Thirdly, PPC recognized VND 199 billion in reverted revenue from realized FX loss (in the past) during the quarter (out of the whole year figure of VND 205 billion). Last but not least, PPC has been reverting its unused maintenance expenses, consequently causing its gross profit to surge in Q4. PPC's maintenance expense was negative 107 billion in Q4/2019 due to the reversal, thus further boosting the gross margin to 22.6%.

PPC's 2019 output came at 5.5 billion kWh (+8.2% yoy), which was within expectations because of the dry weather in Vietnam. Average electricity prices of Pha Lai 1 and Pha Lai 2 averaged VND 1,625 and VND 1,352 respectively, around 4% higher yoy.

For 2020 we forecast that the company will produce nearly 6.2 billion kWh, meaning an average Qc-alpha (Qc/Q) of 77% for both plants. According to ERAV's plan, 2020 CAN price is VND 63.48 per kWh, lower by VND 77 per kWh compared to 2019, and SMP cap is 1,342.3 per kWh, declining by VND 23 per kWh compared to 2019. The CGM in 2020 will remain difficult for participants like PPC to profit from.

Regarding the bottom line, growth potential seems unclear as high Qc is only one of many drivers. Based on its performance in 2019, we revised up our 2020 earnings forecast to VND 1,103 billion (previously VND 769 billion) because of PPC's output plan. However, our view remains that earnings will be lower than in 2019.

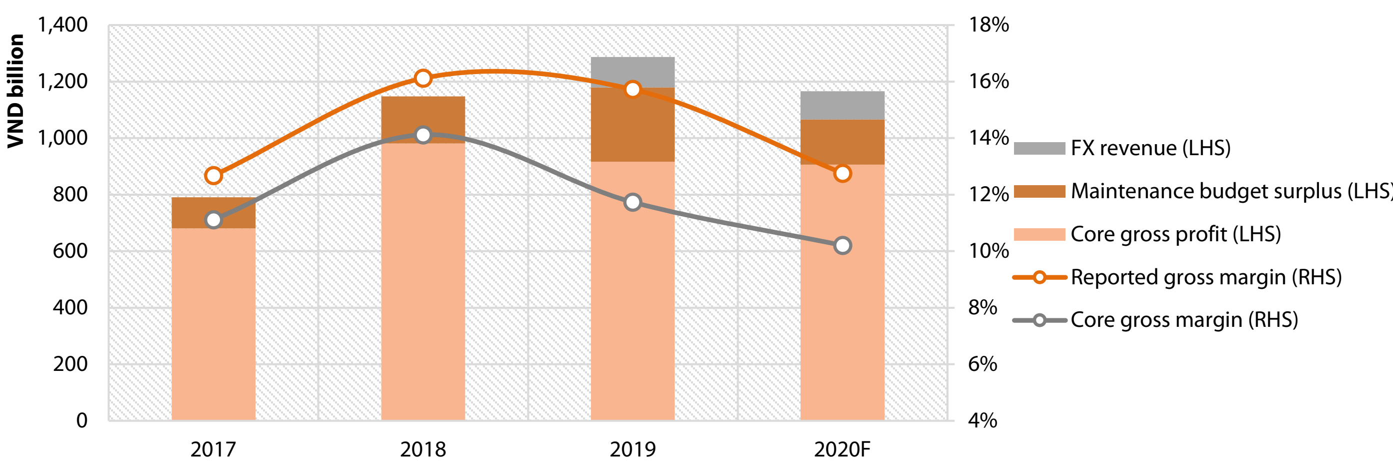
One-off items: A perspective on PPC's core business's profitability

While PPC operated with 'flying colors' in the past two years, it is essential to be able to attribute the incremental profits to their respective drivers. After all, investors need to know which of the contributors they can expect for the next years. Looking into PPC's earning results, we could point out two abnormal items that have questionable continuity for the future.

The first item is revenue for exchange rate variation during the construction period of Pha Lai 2. This brought about approximately VND 107 billion to PPC's 2019 gross profit (contributing 8.3%) and is going to generate another VND 100 billion in 2020. However, investors should bear in mind that this item will be nonexistent from 2021 onward.

The second item is the maintenance budget surplus. We notice that during the last three years, PPC had an annual budget of around VND 430 billion, part of which went unused. The surplus then ended up as gross profit at the end of each year, as per our calculation. As the surplus went up each year, we are concerned that PPC might receive a smaller budget in the future, hence a possible reduction or termination of this abnormal profit.

Figure 1: Gross profit breakdown



Source: PPC, RongViet Securities

Setting these two non-core items aside, we estimate that apart from the exceptional 2018, PPC's true gross margin averages 11% (Figure 1). We think this level of gross margin is relevant in case there is no FX revenue and PPC's budget surplus is minimized for the next few years.

Financials improve as PPC is becoming debt-free

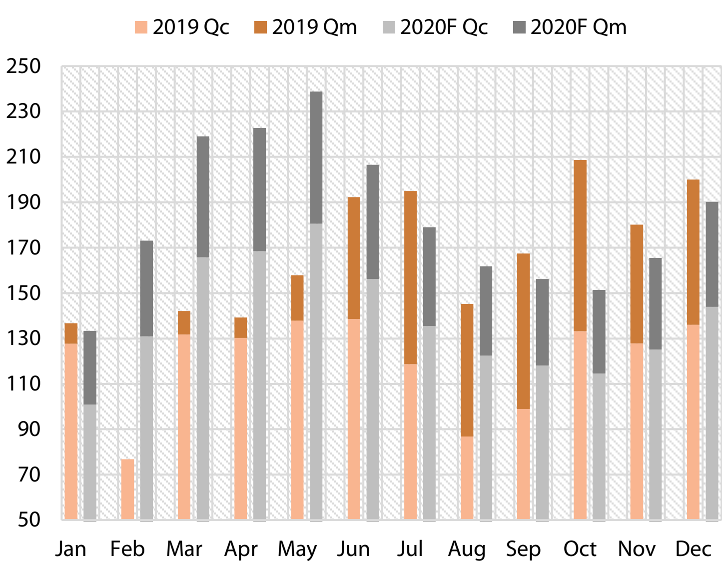
PPC paid off its JPY-denominated long-term borrowing in 2019. As a result, its financial expenses decreased to only VND 15 billion for the year. At the end of 2019, PPC only had VND 127 billion in short-term debt for its coal purchases. We consider this an improvement for PPC's future cash flows.

It was also noticeable that dividend income became a contributor to PPC's earnings in 2019. PPC's dividend income came at VND 178 billion in 2019 (+166% YoY), most of which we believe came from the Hai Phong Thermal Power Plant JSC (UpCOM: HND)'s cash dividend payment. PPC has a 25% ownership in HND, which experienced an impressive earnings growth and paid out a total of VND 1,250 per share in cash dividend for 2019. HND has proved to be a coal-fired plant with modern machinery, sustainable efficiency and solid financials. Therefore, we believe that HND will bring about another considerable amount of cash dividend in 2020 for PPC. We estimate that if HND decides on a dividend payout of VND 1,500 per share out of its 2019's retained earnings, PPC will enjoy nearly VND 130 billion in financial income in 2020.

Q1/2020 forecast

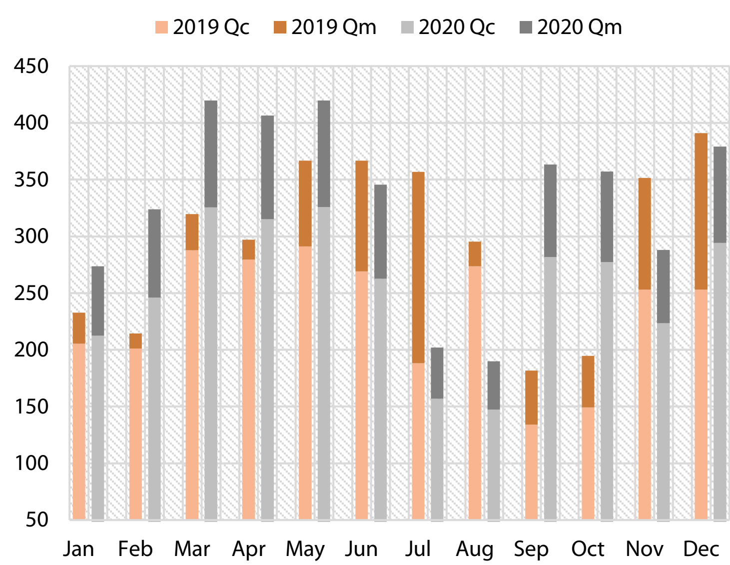
We estimate that PPC's output in Q1/2020 will exceed 1.5 billion kWh, +38% yoy. At an average electricity price of VND 1,430 per kWh, PPC may record VND 2,206 billion in revenue. While the 2020 gross margin is forecasted at 12.8%, that of Q1 is likely higher because of the maintenance cost recognition. Accordingly, we forecast that PPC's NPAT in Q1/2020 will come at around VND 274 billion, the same level as last year.

Figure 2: Pha Lai 1 Plant's monthly output (million kWh)



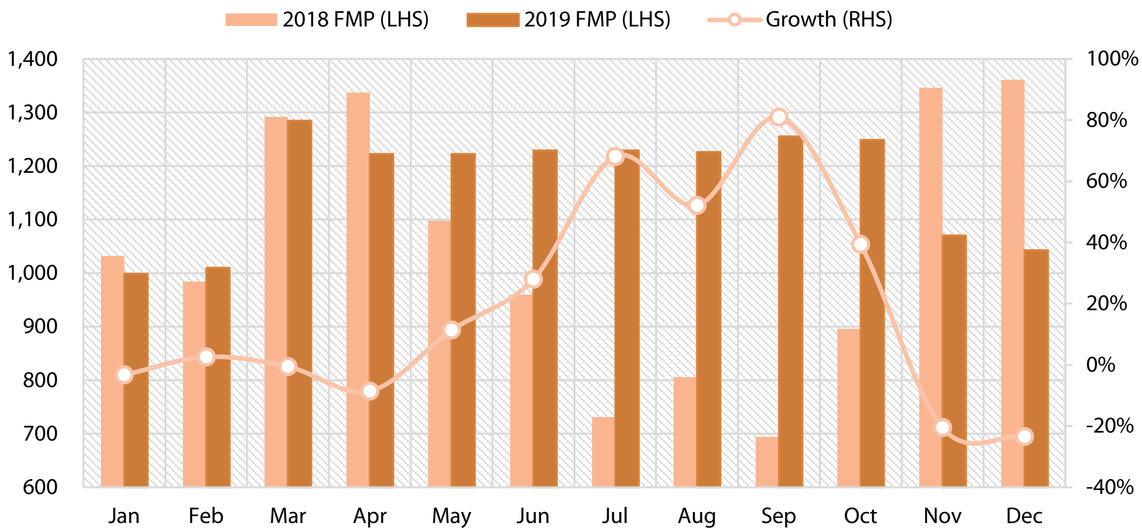
Source: PPC, RongViet Securities

Figure 3: Pha Lai 2 Plant's monthly output (million kWh)



Source: PPC, Rong Viet Securities

Figure 4: Full market price (FMP) (VND per kWh)



Source: PPC, RongViet Securities

VND Billion

INCOME STATEMENT	2018A	2019A	2020F	2021F
Revenue	7,117	8,183	9,138	9,188
COGS	5,970	6,896	7,971	8,094
Gross profit	**1,147**	**1,287**	**1,166**	**1,094**
Selling Expenses	0	0	0	0
G&A Expenses	89	75	86	88
Finance Income	249	310	294	316
Finance Expenses	-115	-15	35	4
Other profits	-14	1	0	0
PBT	**1,408**	**1,538**	**1,339**	**1,319**
Prov. of Tax	285	271	236	232
Minority's Interest	0	0	0	0
PAT to Equity S/H	**1,122**	**1,268**	**1,103**	**1,087**
EBIT	1,058	1,212	1,080	1,007
EBITDA	1,092	1,248	1,114	1,040

%

FINANCIAL RATIO	2018A	2019A	2020F	2021F
Growth (%)				
Revenue	14.1	15.0	11.7	0.6
Operating Income	49.1	14.5	-10.9	-6.8
EBITDA	46.2	14.2	-10.7	-6.6
PAT	31.4	12.9	-13.0	-1.5
Total Assets	-7.6	4.0	-1.5	5.2
Equity	3.2	5.7	4.2	3.8
Profitability (%)				
Gross margin	16.1	15.7	12.8	11.9
EBITDA margin	14.9	14.8	11.8	11.0
EBIT margin	15.3	15.2	12.2	11.3
Net margin	15.8	15.5	12.1	11.8
ROA	16.1	17.5	15.4	14.5
ROE	19.9	21.2	17.7	16.8
Efficiency				(times)
Receivable Turnover	3.1	3.5	4.4	4.7
Inventory Turnover	15.1	15.4	11.0	10.1
Payable Turnover	6.5	7.2	8.2	10.1
Liquidity				(times)
Current	3.0	3.3	4.6	4.2
Quick	2.8	2.8	3.7	3.4
Finance Structure (%)				
Total Debt/Equity	23.5	21.5	14.8	16.4
Current Debt/Equity	23.5	21.5	2.0	3.8
Long-term Debt/Equity	0.0	0.0	0.0	0.0

VND Billion

BALANCE SHEET	2018A	2019A	2020F	2021F
Cash and cash equivalents	143	241	243	296
Short-term investments	1,180	1,060	1,272	1,272
Accounts receivable	2,363	2,251	1,863	2,056
Inventories	237	657	797	809
Other current assets	3	0	0	0
Property, plant & equipment	340	349	307	456
Acquired intangible assets	0	0	0	0
Long-term investments	2448	2481	2481	2481
Other non-current assets	261	218	183	148
Total assets	**6,975**	**7,256**	**7,146**	**7,519**
Accounts payable	770	1,152	792	804
Short-term borrowings	530	127	122	243
Long-term borrowings	0	0	0	0
Other non-current liabilities	0	0	0	0
Bonus and Welfare fund	24	5	10	14
Technology-science, dev. fund	0	0	0	0
Total liabilities	**1,325**	**1,284**	**924**	**1,062**
Common stock and APIC	3,274	3,274	3,274	3,274
Treasury stock (enter as -)	-87	-87	-87	-87
Retained earnings	1,563	1,788	1,949	2,101
Other comprehensive income	184	202	202	202
Inv. and Dev. Fund	717	796	885	968
Total equity	**5,650**	**5,972**	**6,222**	**6,457**
Minority Interest	**0**	**0**	**0**	**0**

VALUATION RATIO (*)	2018A	2019A	2020F	2021F
EPS (dong)	3,501	3,792	3,301	3,252
P/E (x)	8.5	8.4	7.0	7.6
BV (dong)	18,484	19,342	19,986	20,146
P/B (x)	1.3	1.5	1.2	1.1
DPS (dong/cp)	2,500	2,700	2,500	2,500
Dividend yield (%)	11.0	9.5	11.0	11.0

VALUATION MODEL	Price	Weight	Average
FCFE	23,544	30%	7,063
P/E	21,956	40%	8,638
EV/EBITDA	22,760	30%	6,828
Target price (VND)			**22,500**

VALUATION HISTORY	Price	Recommendation	Period
23/10/2018	19,268	BUY	Long-term
14/12/2018	20,940	BUY	Medium-term
13/12/2019	23,686	NEUTRAL	Medium-term

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.

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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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